S. HRG. 102–134

TELECOMMUNICATIONS EQUIPMENT RESEARCH AND MANUFACTURING COMPETITION ACT OF 1991

HEARING

BEFORE THE

SUBCOMMITTEE ON COMMUNICATIONS

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

UNITED STATES SENATE

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

ON

S. 173

TO PERMIT THE BELL TELEPHONE COMPANIES TO CONDUCT RESEARCH ON, DESIGN, AND MANUFACTURE TELECOMMUNICATIONS EQUIPMENT, AND FOR OTHER PURPOSES

FEBRUARY 28, 1991

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THE TELECOMMUNICATIONS EQUIPMENT RESEARCH AND MANUFACTURING COMPETITION ACT OF 1991

THURSDAY, FEBRUARY 28, 1991

U.S. SENATE,
SUBCOMMITTEE ON COMMUNICATIONS
OF THE COMMITTEE ON COMMERCE, SCIENCE,
AND TRANSPORTATION,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:10 p.m., in room SR–253, Russell Senate Office Building, Hon. Daniel Inouye (chairman of the subcommittee) presiding.

Staff members assigned to this hearing: John Windhausen and Toni Cook, professional staff members; and Regina Keeney, minority professional staff member.

OPENING STATEMENT OF SENATOR INOUYE

Senator INOUYE. The Communications Subcommittee meets this afternoon to receive testimony on S. 173, legislation introduced by Chairman Hollings to alter the modification of final judgment by repealing the communications manufacturing restriction on the Bell operating companies. The full committee approved similar legislation last Congress but that legislation was not considered by the full Senate.

The chairman of our committee, Senator Hollings, believes that the time has come to lift the communications manufacturing restriction and institute a new series of administrative safeguards against anticompetitive behavior.

Because of the chairman's longstanding and in-depth involvement in telecommunication issues, I generally agree with his position on most issues. Thus, I deeply regret that I find myself at some odds with the chairman on this bill.

However, I continue to believe that on balance, the modified final judgment is of great benefit to our telecommunications market, its businesses and users. Thousands of new manufacturers have entered the market since the AT&T divestiture. As a result, consumers have benefited from cheaper and more innovative equipment and many new services.

The trade deficit in communications equipment has been reduced from $2.6 billion in 1988 to $800 million in 1990 according to the Department of Commerce. In the area of research and development, spending by U.S. companies, including the RBOC's, has increased, not decreased since divestiture.

Further, we simply cannot ignore the regional Bell operating companies' incentives and capabilities to engage in anticompetitive acts stemming from their control of the bottleneck over local telephone equipment.

The recent violations of NYNEX and US West are only the latest examples of the Bell companies' potential to cross-subsidize and engage in discriminatory pricing.

This hearing, however, gives all of us an opportunity to hear both sides of the issue and raise any concerns that we may have. I am pleased that we have a compromise proposal to discuss this afternoon. I consider the proposal that has been put forth by the TIA, the IDCMA, and NATA, to be a constructive step to resolving this dispute.

I recognize that the Bell companies do not believe that this proposal goes far enough. I would like the Bell companies to respond to the proposal and to indicate if there are any aspects of the proposal that appeal to them.

For example, at last year's hearing, one Bell company suggested that their primary concerns were design and development, not with fabrication. I would be interested to know whether this proposal would address the Bell companies' concern about design and development. Rather than take up anymore time with my concerns, I will raise the remaining issues in my questions.

Before I call upon the first witness of this hearing, I am pleased to call upon our chairman, Senator Hollings.

OPENING STATEMENT OF SENATOR HOLLINGS

The CHAIRMAN. Thank you, Mr. Chairman. I thank you for setting this hearing, and the members of the committee and subcommittee for their interest, and in many instances, their support.

As you know, this is quite similar to the bill that we reported out last year with a few alterations and we are ready to move on. And as we move from the recession to the recovery, as we move from the gulf war to the trade war, we find our opportunity here to put some of the best institutions in all of America, in a competitive, productive developing mold.

Let me emphasize what has really happened. We had grave misgivings from the experience of the old AT&T Bell system. I think at one time, because I have been on the committee now, this is my 25th year, that we had 12 orders outstanding by the FCC that the lawyers for those entities were getting around. Their representatives were up here and had the votes. We could not get a bill through, trying to deregulate, and otherwise. And the Department of Justice finally took it over and then everyone agreed to the modified final judgment.

And in that the intent was, look, let us not allow AT&T to take over and preempt competition. What we are trying to do is develop it. And therefore, we will bar them from going into advertising. And we will bar them from long distance. And we will bar them from manufacture.

And as I studied this particular matter, the restrictions on information services and advertising, and the restriction on long distance, are well placed. But with respect to manufacturing, the in-

tent has been totally thwarted by foreign competition, foreign investment, foreign takeovers.

There are about 66 companies that have already been bought out, high technology, American businesses by foreign firms. And you only have to go to the patent office and see who is filing the patents because there is no incentive for the Americans to invest, to develop, to compete, to improve as long as they cannot make a buck out of it. So, the Bell companies take their money and go to Hungary to install a cellular system, or to Moscow, trying to put in optic fibers from Moscow to Tokyo and everywhere else. They are investing. They are not waiting around on the political Congress to make a judgment. They have had to move on.

But unfortunately, this develops Europe, and South America, and New Zealand. And we sit here, still on our own patois, thinking that we are in control. We are in global competition and you just cannot control these things. And if we can, certainly, bring our various Bell companies into the arena of research, and development, and production, where there is no self-dealing, no cross-subsidizations, wholly owned entities then we will be able to compete in a way that benefits the United States.

And now, particularly, with a viable Federal Communications Commission that has an auditing system that was formerly lacking in the use of computers, heretofore, the FCC can now account for cost and so forth, to make sure that there is not any cross subsidization. We ought to move in that direction.

My understanding is that the administration supports this bill with two misgivings. One with respect to the domestic content feature and the other, they would prefer that the FCC have the checks with respect to cross subsidization and self-dealing and other things of that kind, rather than it be written in the statute.

Let me just say that I understand what they are trying to get after with respect to the matter of their opposition to the domestic content. That is a lead that America had over the years after World War II and it was going to work, I guess, for awhile. We were the only industry, the only manufacturer that existed. We taxed ourselves. The Marshall plan has worked and the leadership with technology that has been distributed the world around has worked. They have gone capitalistic, democratic, and we are all happy about it.

However, as we study it closely, we realize, of course, that the United States is no longer setting the example. Rather MITI in Japan has set the example. And now the Taiwanese, the folks in Hong Kong, the folks down in Singapore, the folks in Korea, and then in much extent as we watch EEC 1992 develop, realize that their government subsidies, their government protections, their government financing, and otherwise, are giving their firms a comparative advantage and the economic formula for today.

So, while we sit back here with our GATT, we should understand that we have got to modify our arrangement with GATT, Senator. But 60 percent of the clothing in this place is imported and if they continue on with what they are proposing in GATT, all our clothing will be foreign made by the year 2000.

Eighty-four percent of the shoes on the floor in this room are already imported. The electronics business is gone, as is the hand

tool business. And now even the banks that used to sit back with the service economy, the banking, insurance, and everything else are facing greater foreign competition. The Government of Germany put in that bid for that contract out in Saudi Arabia some years ago, and beat us out because the bank had put up the performance bond. The bank was part of the business. That is the competition.

Now you can sit around and talk. How can we argue for free trade in GATT if we include a domestic content provision in this bill? I can tell you now, that argument is by the board. We live in the real world. The GATT has not worked at all. And as they say, market forces, that is it. Let the market forces operate.

And in that sense, when we make it to their economic interest, then the Japanese will deal. I do not blame them for not negotiating before that. All the Europeans know that in order to remove a barrier you have got to raise a barrier. That is the market force. That is the competition we talk of and then we will remove them both.

But if we sit around here like dreamers from Brookings, and talk about theory, looking at things that work in reality and wonder when it is going to work in theory, we will all sit around here with nothing but politicians and news media. We do not import either one of those yet. They are trying to figure out a way to import them after 12 years. There is a limit initiative going on in the country today because the people are getting angry with our rhetoric and no action and no result up here.

So, GATT is not working. It controls less than 20 percent of the trade and we have got to move into the real global competition. This will allow some of the finest entities in American business and industry; namely our Bell companies, to come home, like old George used to say in that 1972 race, and invest in their own people, and with my communication workers, we have worked out a formula here where 40 percent, at least, of the components must be made domestically.

Now, I will never forget, just to be specific, when AT&T came around with their switchboards, they did not realize that we were going to look even closer. And we found out that old switchboard was foreign. Everyone of those little computer chips in there were made in Taiwan or other countries. And they were talking about domestic manufacture.

I should know it well. I competed with Senator Hodges in North Carolina 30 years ago. He won. He got Western Electric. But I won. I got Eastman Kodak. Now his Western Electric is all over in Singapore. It is gone. It is gone but not forgotten.

And so, I am trying to move along and I would appreciate your help and I hope I can change your mind. I was not your classmate at that night law school you struggled through. But I am a close friend of yours, Mr. Chairman. I hope you will give me consideration.

Senator INOUYE. Senator Pressler.

OPENING STATEMENT OF SENATOR PRESSLER

Senator PRESSLER. Mr. Chairman, I am very pleased that we are once again examining the question of the Bell companies entering the business of manufacturing telecommunications equipment.

At last year's markups, I said I had some concerns, but I did not object. However, my concerns over the incentive for Bell operating companies to engage in anticompetitive behavior were heightened recently when US West admitted to four violations of a consent decree and agreed to pay a fine of $10 million.

The Justice Department's investigation found that US West had engaged in anticompetitive behavior and discriminatory pricing. At the same time, the Department dropped nine other investigations. I think the case may bear directly on the legislation we are considering today. If we cannot control these monopolies under the existing restrictions, I am not sure we ought to be giving them more freedom in new areas such as manufacturing. That is the heart of my concern, and it is something I need to see much more information on before making a final decision on this issue.

The US West experience has made me much more skeptical. Last year, the consumer groups, senior citizens, small business manufacturers, State regulators, and individual ratepayers warned me about exactly this type of behavior. I am beginning to see their point.

A majority of my constituents are US West ratepayers. I received numerous inquiries from South Dakotans asking questions about this investigation. They are directly affected, and very concerned about this case.

I have asked US West to provide records and some answers that would detail a description of the four admitted violations and nine other allegations that were dropped. I have also requested more detailed information whether any of the admitted or alleged improper activities involved the funds or personnel of regulated telephone companies.

I did meet with the Justice Department yesterday on these matters. I did send a letter to US West which I wish to make a part of the record. Just before coming to this committee I received a very brief, one-page nonanswer really, just offering a meeting. But to satisfy me, I shall need some written responses to place in the Congressional Record and also in the record of this committee, and I feel that this committee needs to have more information on the various matters surrounding that fine, the largest fine in history.

Mr. Chairman, I believe the fundamental premise of S. 173 is that adequate safeguards can be built into the legislation to prohibit violations similar to those of US West. If the recent press accounts of US West involvement in anticompetitive behavior are accurate, that premise is much less compelling.

If we cannot control and better understand the extent of violations occurring today, how can we determine if the safeguards proposed are adequate? How will consumers be affected? Are ratepayers subsidizing these activities?

We do not know from any of the information that has been released so far, and that is why I have asked for more. Our committee must rely on sketchy press reports and limited information that the Department of Justice is allowed to release regarding its investigations.

Mr. Chairman, I would like to ask your assistance in getting answers to these questions before we begin voting on this bill.

I ask unanimous consent to submit for the record my letter to US West and the company's response. When they do do it, I would like to make their response a part of the record along with some additional material.

If we as a committee are to decide the telecommunications policy of this Nation, we should have a full accounting of the effectiveness of past regulations before we act. I am hoping these answers will be forthcoming. I ask unanimous consent to place my letter into the record.

Senator INOUYE. Without objection, so ordered.

[The information referred to follows:]

LETTERS FROM SENATOR PRESSLER TO MR. RICHARD MCCORMICK

FEBRUARY 26, 1991.

Mr. RICHARD MCCORMICK,
Chief Executive Officer, U.S. West, Inc., 7800 East Orchard Road, Suite 200, Englewood, CO 80111

DEAR MR. MCCORMICK: Thank you for your letter in support of legislation to allow US West to manufacture telecommunications equipment. We had understood that US West was to present industry testimony but that you withdrew from consideration in light of recent antitrust violation reports. I am disappointed you will not be present to address this issue. I believe it may have a direct bearing on the legislation being considered.

I wanted to inquire about recent press accounts concerning consent decree violations by US West. These accounts indicate that US West has engaged in "anti-competitive behavior," "discriminatory pricing," and other actions resulting in the largest civil penalty ever levied in the history of the Justice Department's Antitrust Division.

According to the partial reports thus far, it appears that US West has admitted to four consent decree violations and that nine other violation investigations were dropped as part of the settlement. The record ten million dollar fine imposed for the four acknowledged violations and the initial press accounts of the other nine investigations which were dropped indicate that these thirteen violations are of a serious, deliberate nature, rather than "inadvertent" actions.

Most of my constituents are US West ratepayers. I am deeply concerned about the consumer impact of US West's actions, and would appreciate further information.

The Commerce Subcommittee on Communications is holding hearings on legislation that would lift certain decree restrictions, allowing your company to become directly involved in manufacturing. As you know, a fundamental premise of that legislation is that adequate antitrust safeguards can be built into statutory language, thus permitting the modification or removal of the line of business restrictions. If the recent accounts of US West's involvement in anti-competitive behavior are accurate, that premise is much less compelling.

The reports in the US West case cast serious doubt on the ability of regulatory authorities to prevent abuse of any additional freedom that may arise from new legislation. If we cannot adequately police the relatively bright lines set forth in the consent decree, there will be much less enthusiasm for blurring these lines through legislation to partially remove line of business restrictions.

But I do hasten to add that the information on this case is incomplete. I have been very disappointed by the lack of complete information available in this extremely important case. I do not want to make fundamental policy decisions based upon sketchy and incomplete press reports. I think it is important that the Communication Subcommittee act on the basis of a full understanding of the extent to which US West has been in compliance with or violation of the consent decree, and all information necessary to judge the relevance of those actions to the legislation being considered. I hope that this desire for an open exchange of information and ideas is one we both share.

Toward this end, I would like to review in greater detail the information and background material associated with the thirteen counts listed against US West. Therefore, it is requested that you please provide the following:

1. A detailed description of the four admitted violations and the nine other allegations which were dropped. Please include copies of all documents submitted by US

West's representatives to the Department of Justice throughout its investigations which characterize the violations and allegations set out in the enforcement order.

2. Information on whether any of the admitted or alleged improper activities involved the funds or personnel of your regulated telephone companies. If so, please provide data on the costs attributable to regulated investments and expenses in the Federal and in each state's jurisdiction.

3. A listing of all disciplinary action taken or planned against the officers and employees of US West who are responsible for these offenses.

I look forward to hearing from you in regard to this request prior to any Committee votes on the legislation. If March 6, 1991 is a reasonable time frame to prepare the material, that would be optimal. This legislation will have a profound impact on my constituents. Your specific antitrust case does, as well.

Before I can support such legislation I need more information in order to judge the relationship between the two, and whether the net impact on my constituents is positive or negative. This letter and your response will be included in the record of the Communication's Subcommittee hearings on February 28, 1991.

Sincerely,

LARRY PRESSLER,
United States Senator.

FEBRUARY 28, 1991.

Mr. RICHARD D. MCCORMICK,
President, US West, Inc., 7800 East Orchard Road, Suite 200, Englewood, CO 80111

DEAR MR. MCCORMICK: Regarding your letter of today, let me assure you that I read your press release and accompanying material delivered on February 15, 1991. Nothing there answered the questions in my February 26 letter. I would appreciate a written response to the concerns raised in my letter, and specific answers to the specific questions.

Additionally, at today's hearing the Justice Department confirmed that ratepayer funds were involved in the violations. I would appreciate a detailed accounting of the extent of that involvement, and the number of employees engaged in these activities.

I would be glad to meet with you anytime. However, I think such a meeting would be more constructive after we have a chance to review the information I requested in writing.

Finally, I was a bit concerned about the impression left by a private company proposing a meeting for the Justice Department. I already have met with the Justice Department. They were professional and responsive.

I look forward to a detailed response to the questions and concerns I raised on behalf of my constituents, consumer groups, senior groups and small businesses. Thank you.

Sincerely,

LARRY PRESSLER,
Unite States Senator.

LETTER FROM RICHARD D. MCCORMICK TO SENATOR PRESSLER

FEBRUARY 28, 1991.

The Honorable LARRY PRESSLER,
U.S. Senate, SH–133 Hart Senate Office Building
Washington, DC 20510–4101

DEAR SENATOR PRESSLER: I am in receipt of your letter of February 26, 1991, requesting the details of the recent settlement by US WEST with the Department of Justice. On February 15, 1991, the day of the settlement, a letter was delivered personally to your office from Laird Walker explaining the nature of the settlement and making an offer to provide additional details to you.

I now propose that Jim Smiley and I, together with representatives of the Department of Justice meet with you to discuss the nature and terms of the settlement. Jim and I are available on March 19, and, if representatives of the DOJ are agreeable, we could spend whatever time would be necessary to make you comfortable with the terms of the settlement and to assure you that South Dakota ratepayers are not disadvantaged.

I look forward to an opportunity to meet with you in the near future to discuss your request.

Very truly yours,

DICK MCCORMICK.

STATEMENT OF SENATOR PRESSLER

The following correspondence or any subsequent communication did not provide answers to my central question on the amount of ratepayer funds expended in developing the thirteen lines of business in question.

LETTER FROM RICHARD D. MCCORMICK TO SENATOR PRESSLER

MARCH 4, 1991.

The Honorable LARRY PRESSLER,
U.S. Senate, 133 Hart Senate Office Building,
Washington, DC 20510–4101

DEAR SENATOR PRESSLER: In your letters of February 26 and 28, 1991, you asked me to provide the answers to three sets of questions about US WEST's agreement with the U.S. Department of Justice. Specifically, you asked for:

1. Detailed descriptions of the 13 business activities that were part of the agreement and copies of all documents submitted to the Department in the course of its investigation.
2. Information on which of the activities involved the regulated telephone companies and a breakdown of the number of employees and the costs in state and federal jurisdictions of these activities.
3. A discussion of any disciplinary actions taken or planned by US WEST.

I am able to respond in full to your first and third sets of questions in this letter and attachments.

We are working to compile the answers to your second group of questions, and we will have a report for you by Friday, March 8.

As for the first part of your first set of questions, each of the 13 business activities is described in the first attachment to this letter. As for the second part of your first request, US WEST delivered to the Department some 900 boxes comprising about 1,450,000 pages of documents. Copies of these documents are maintained in Denver and are available for your immediate inspection here, or in the very near future, in Washington, D.C., whichever you prefer.

I understand that Laird Walker, our vice president of Federal Relations, told Mr. Schieffer of your office about the volume and location of the documents and that Mr. Schieffer asked that we not deliver them at this time. He asked if, instead, we had an index of the documents. We have transmittal letters and logs showing the range of document numbers in each box, but they don't describe or index them. These logs are being reproduced and will be delivered to you this week.

As for the third set of questions, the four admitted violations were the subject of vigorous debate between in US WEST and the Department for varying periods of time. In other words, the violations resulted from differing interpretations of the Modification of Final Judgment. It's my feeling that the employees involved were acting in good faith and were executing their responsibilities conscientiously. Therefore, we have not disciplined any employees in these matters. The other nine activities we deny were violations and, further, assert that we never even engaged in some of them.

US WEST recognizes that the Modification of Final Judgment is one of the most important sets of rules governing our business and we have ensured that every management employee in the company has read it and understands it. In addition, we have provided all managers with copies of an earlier agreement between in US WEST and the Department and have required that employees read it and understand it. Finally, we are providing all managers with copies of the latest agreement and requiring that they read it and understand it. In all cases, employees are told that failure to comply with any of these sets of rules will result in disciplinary action up to and including dismissal.

Our main reason for entering into the agreement with the Department was to avoid lengthy and costly litigation.

I hope these responses to your questions—with the exception I noted earlier—are satisfactory. Please let me know if you would like to meet in person to discuss these

issues further. If you would, I will be in Washington and available to meet with you this Wednesday afternoon, March 6, 1991.

Very truly yours,

RICHARD D. MCCORMICK.

ATTACHMENT I

Attached are specific descriptions of the four inadvertent violations: Sale of Switching Services to GSA; Computer Facilities Management Services; Reverse Directory Services; and Operator Workstation.

The September 1985 Sale of Switching Service to GSA

US WEST was awarded a bid in September 1985 to provide private line switching services to the GSA in Denver, Albuquerque, Phoenix and Salt Lake City. AT&T, an unsuccessful bidder, complained that the pricing of local exchange facilities was improper, contending that the US WEST service was priced according to rates for Centrex services established by state regulatory bodies. AT&T alleged that those rates were lower than the ones established by the Federal Communications Commission for the use of local exchange facilities to connect AT&T's interstate switching services.

Specifically, AT&T contended that for calls from the FTS network to numbers not part of that network, the US WEST proposal treated the call as it would any call made from a Centrex station. That is, as a simple local call, since the switching service used by US WEST was part of the Centrex system. However, if such calls were received by US WEST from AT&T's switching facilities, the calls were treated in the same manner as any long distance call and access charges were assessed.

AT&T also complained that it was improper for US WEST to charge AT&T for facilities between the AT&T private line switch and the US WEST Centrex switch, unless US WEST imputed a charge to itself to "move" within the software of the Centrex switch when the Centrex switch was used to provide both the private line switching service and the traditional Centrex service, or to move within the US WEST central office if two switching machines were used.

Prior to presenting its proposal to the GSA, US WEST carefully examined whether state Centrex prices of interstate CCSA prices were applicable. Access tariffs were still being developed by the telephone industry while the GSA bid was being formulated. There was much confusion as to what rules would be used to establish prices.

AT&T ultimately presented its complaint to Judge Greene. US WEST and other divested Bell companies argued to the judge that the MFJ did not prohibit applying different intrastate and interstate rates dependent upon the nature of the service and whether an interstate or local exchange carrier was providing the service. In a November 26, 1986 order, Judge Greene directed US WEST to price the local exchange facilities the same, regardless of which company provided the switching service.

The order was appealed to the Court of Appeals. The court affirmed Judge Greene's ruling, but, in its findings, the court specifically stated that the "relevant sections of the MFJ are not entirely free from ambiguity."

As a result of the court's ruling, US WEST repriced the services. (See description of "Provision of Switching Services to GSA.")

Subsequently, the FTS 2000 network replaced the services.

Computer Facilities Management Services

In 1986, US WEST acquired the outstanding stock of an Omaha company named Applied Communications Incorporated. ACI was engaged in the development and sale of software systems used for electronic funds transfer machines and other banking accounting systems. Before the purchase, US WEST examined the activities of ACI and talked with ACI's managers. US WEST also provided the Department of Justice with various documents describing ACI's business activities, including its securities prospectus and its 10–K form. US WEST discussed these documents with the department.

However, US WEST later became aware that one of the hundreds of worldwide contracts ACI had outstanding involved the provision of a point-of-purchase network at its gas stations in California. Customers would insert their credit cards into gas pumps and would be automatically charged for the amount of gas they put into their tanks. The use of ACI personnel to manage this network made it a prohibited information service.

In November 1987, US WEST became aware of the unique nature of the ARCO contract and took immediate steps to terminate the use of ACI personnel. There had been not complaint by anyone and, until advised by US WEST, the department had been unaware of the activity. Since then, ACI has not entered into any contracts to provide personnel to actually operate data processing systems.

Reverse Directory Services

Prior to and after divestiture, Pacific Northwest Bell, Mountain Bell and Northwestern Bell provided a variety of services involving the furnishing of customer addresses, an activity the department contended was not allowed by the MFJ. These included responding to calls to Directory Assistance for the address of a subscriber and offering a database containing customer name, address and phone number that could be accessed by a personal computer. Other services offered from time to time included providing daily updates to subscriber address listings, and verifying the accuracy of address and phone numbers information contained on magnetic tapes of other entities.

After discussions between US WEST and the department as to whether such services were permissible directory services or prohibited information services, US WEST terminated all such services and, instead, sought a waiver of the MFJ. In June 1989, Judge Greene granted US WEST a waiver to allow it to provide addresses as part of its Directory Assistance services.

Operator Workstation

In 1986, US WEST acquired a company that developed software that would allow an ordinary personal computer to be used to provide operator and Directory Assistance services at a significantly lower cost than equipment then available. US WEST continued to develop the capabilities and offered the software and computers for sale to other telephone companies.

In December 1987, Judge Greene issued an order defining and interpreting the scope of the manufacturing restriction contained in the MFJ. Within several days, US WEST wrote to the department to clarify whether the activities of the US WEST entity (known as KEI) engaged in the operator workstation development raised MFJ manufacturing issues.

Thereafter, US WEST fully described KEI's activities to the department in various letters and memoranda, explaining that US WEST believed the waivers of the MFJ allowing US WEST to provide computers and software encompassed KEI's activities. Nevertheless, in April 1989, US WEST determined, for business reasons, to terminate the KEI activities, and so advised the department. The department told US WEST in May 1989 that it had concluded that the development and provision of the operator workstations were not allowed by the MFJ.

ATTACHMENT II

Following are descriptions for the nine activities, which we deny were violations and, in one case, even deny having engaged in.

GSA Sales in Seattle

In late 1987, US WEST was awarded a contract to provide switching services to the GSA in Seattle. AT&T contested the award before the GSA's Contract Appeals Board, but the board determined the contract had been properly awarded and denied AT&T's appeal. No MFJ issues were included in this appeal.

Provision of Switching Services to GSA

This activity involved repricing the Denver, Albuquerque, Phoenix and Salt Lake City switching services as a result of Judge Greene's November 26, 1986, order, in which he directed US WEST to price local exchange facilities the same regardless of whether AT&T, as an interstate carrier, or US WEST as an intrastate carrier provided the switching service. US WEST met with the Department of Justice after Judge Greene's order and reviewed the proposed repricing. Justice concurred and US WEST changed the billing for the services.

FTS 2000

This activity involved the pricing and provision by US WEST of its local exchange service to various contractors who were submitting bids to the federal government for services known as FTS 2000. FTS 2000 was designed to replace the FTS network. No complaint or controversy was ever raised by anyone, including the Department of Justice, regarding US WEST activities associated with providing the local exchange portions of FTS 2000.

The department did not request any documents and, as far as we know, did not interview anyone on this subject. This activity was included by US WEST in settle-

ment with the department's concurrence, to include and conclude all aspects of GSA in the settlement.

VuPoint Polling Service

This tariffed service was offered only on a trial basis and only in Phoenix, Seattle and Des Moines between June 1987 and early 1989. The service would have allowed a sponsor, such as a television station, to be assigned to two or more numbers. The numbers could then be advertised, with instructions that by dialing a specific number, a caller could express a preference. US WEST would then tabulate the number of calls and advise the sponsor, who could report the tabulations. US WEST planned to charge either the calling party or the sponsor, at the direction of the sponsor. Charges would have been based on usage.

The Department of Justice wrote US WEST on January 4, 1988, requesting an explanation of VuPoint, specifically, whether it raised concerns under the information services restriction of the MFJ. US WEST replied that the service as designed to inform a subscriber of how many calls were received and that the activity was no different than tabulating message units in usage sensitive locations and then displaying such information on a customer's bill.

A significant consideration to US WEST was the fact that VuPoint was designed to make minimal use of the network through a network configuration that counted call attempts in each central office. A particular call, therefore, would not have to be transported to a central location for counting. For example, if a sponsor made use of their equipment for counting, every call made would have to be transported to the sponsor's premises. With VuPoint, calls would not leave a local exchange office. Instead, US WEST could count calls in each central office and transmit the totals to a central point only once.

The Justice Department did not respond to US WEST's explanation until interrogatories were sent to US WEST in late 1988 requesting additional information. US WEST furnished answers to the interrogatories and, since that time, no further action has been taken by the department. To the best of our knowledge and belief, the provision of VuPoint did not violate the MFJ.

This activity was included in the settlement by US WEST because the department had originally indicated it intended to inquire into this matter and to terminate formally that inquiry. US WEST produced documents, but to our knowledge, the department did not interview any witnesses.

Talking Yellow Page Services

In August 1986, a Denver firm named Information Express was created to provide Yellow Page-type information over the telephone, under the name "Hello Yellow." While the firm had no financial ties with US WEST Direct, an informal marketing agreement existed, whereby advertisers in US WEST's printed directories could purchase a subscription to the Hello Yellow service. The Hello Yellow logo and a four-digit number would then appear in an ad in the US WEST printed directory.

A directory user could read the printed ad, call the Hello Yellow operators and receive extensive and updated information regarding the advertiser's services or products. US WEST was interested in gathering information about whether such a service was useful to directory readers and whether the value of our directory would be enhanced by the Hello Yellow service.

In analyzing this activity, US WEST relied in large part on an arrangement in Minneapolis, in which US WEST's cellular company had allowed an information provider to install equipment in US WEST's cellular switch. The information provider could then provide information services to cellular customers. The Department of Justice agreed that this activity was permitted under the MFJ, and thereafter cited it as an example of what could be done under the MFJ to provide Bell Company customers with information services.

Thus, US WEST believed it was engaged in virtually an identical activity by offering Hello Yellow the ability to place its logo and number in printed directory ads, and by asking its print advertisers if they would be interested in making use of the Hello Yellow capability.

The Department of Justice met with US WEST for the purpose of discussing this activity on several occasions in 1987. Those meetings included the principals of Information Express, one of whom was a former lawyer at the Department of Justice. During much of the same time period, the department was engaged in an investigation of a somewhat similar activity offered directly by NYNEX. The department ultimately concluded that NYNEX must stop providing the service.

In February 1988, US WEST decided to stop even the limited role it was engaged in. The company believed that the department might not agree that US WEST could make its print customers aware of the Hello Yellow service while seeking to sell

printed advertising. The other firm, Information Express, thereafter ceased to continue in business.

US WEST produced documents at the department's request, but, to our knowledge, the department did not interview any witnesses. This activity was included by US WEST in the settlement to conclude formally the department's inquiry.

Payphone Sale Practices

A complaint was made to the Department of Justice by a competing public phone provider regarding a bid proposal to an agency of the state of Colorado for phones to be used by prison inmates. US WEST stated that interLATA calls using its payphones were completed by AT&T. Only AT&T could provide the services necessary to allow inmates to pay for calls by reverse charging arrangements or by the payment in coin. At that time, no other interexchange carrier was interested in offering such capabilities.

US WEST demonstrated to the Justice Department that the state of Colorado understood that US WEST was neither holding itself out as having the ability to offer interexchange services, nor providing any endorsement of AT&T's services. Indeed, AT&T entered into a separate contract with the state to provide interexchange services. The contract for public payphones was awarded to US WEST.

This activity was included in the settlement because the department had originally indicated it intended to inquire into this matter and in order to terminate formally the inquiry. US WEST produced documents, but the department did not interview any employees, to US WEST's knowledge.

Tape Data Stacking Utility

Mountain Bell developed software for internal use called Tape Data Stacking Utilities (TDSU) that made more efficient use of tapes in a data processing center. The development work was done in Mountain Bell's own data processing center for its own needs. Seeing a need for this system in other companies, Mountain Bell entered into licensing agreements with non-affiliated telephone companies and with non-affiliated non-telephone companies. It also entered into a relationship with a software sales company named Alltran to solicit other potential purchasers of the software.

US WEST obtained a waiver of the MFJ to allow it and its telephone companies to develop and sell software on May 13, 1986. This waiver allowed US WEST not only to develop software, but also to sell software to any entity. Any sales of software by the telephone companies, as distinct from sales by the rest of US WEST, were restricted to other local exchange carriers.

However, sales of the TDSU software were made to a handful of companies in the weeks prior to obtaining the software waiver. In addition, sales were made before and after the waiver by Mountain Bell to non-telephone companies. Thus, in these two respects, the department might have argued that the waiver was violated.

US WEST did not agree with such an interpretation, because it believed the sales were ancillary to permitted activities. Thus at the time they were made, the software sales were deemed to be isolated sales of permitted software, which had been developed not for public sale as a line of business, but rather, to facilitate the provision of local exchange services by reducing data processing costs.

The department never rendered a conclusion to these arguments. the obtaining of the software waiver, together with the elimination of section II(D)(3) of the Decree in September 1987 (which eliminated restrictions on sales by the telephone companies), effectively brought all sales thereafter in compliance. This activity was included in the settlement by US WEST because the department had indicated it intended to inquire into this matter and US WEST desired to terminate formally the inquiry. US WEST produced documents, but the department did not interview any employees, to US WEST's knowledge.

Cellular Credit Card Phones

In 1984, US WEST's New Vector Group contacted three manufacturers seeking interest in manufacturing a cellular telephone set that would accept a credit card. Only one, a company called OKI, expressed interest. OKI then provided US WEST with proposed specifications for the phone. US WEST offered comments on the proposed design, and ultimately OKI manufactured and provided approximately 50 such phones to US WEST. They were placed on ferries, buses, limousines and in portable payphone kiosks.

US WEST believed strongly that its provision of standards for the interconnection of the phone to its cellular network, including the provision of generic specifications for the appearance of the phone, the volume levels that the phone should allow and the functions of the feature buttons, were exactly the type of generic or functional specifications Judge Greene has told the divested companies they could provide.

The department has never disagreed with this conclusion. This was included in the settlement by US WEST simply because the department had originally indicated it intended to inquire into this matter and to terminate formally the inquiry. US WEST produced documents, but the department did not interview any employees, to US WEST's knowledge.

One-Call Notification Services

For more than 15 years, Northwestern Bell provided an underground utility location service. Advertising, posted signs, and educational programs encouraged people to call a number answered by Northwestern Bell employees. Northwestern Bell allowed other utilities to share in their costs. In return, Northwestern Bell agreed to notify affected utilities of planned excavations.

In late 1986, an unsuccessful bidder for the right to provide the Omaha notification service complained to the Department of Justice that Northwestern's provision of the service violated the information services restriction in the MFJ. The department and US WEST had numerous meetings to discuss this issue and the department determined in March 1987 that US WEST should stop providing the service.

US WEST did not agree with the department, contending that the service was a natural part of operating numerous underground facilities. In addition, US WEST did not believe the sharing with other utilities constituted engaging in a line of business under the MFJ. Nevertheless, US WEST decided that it would no longer answer such calls, but would instead look to others to answer the calls and relay the information. US WEST thereafter would simply pay its share of the expenses of the service. US WEST terminated the service and so advised the Department of Justice.

However, we later learned that an employee in North Dakota had continued the service beyond the termination date by several weeks to enable Continental Telephone to arrange for an alternative to Northwestern Bell. The employee believed such action was reasonable because it would prevent Continental exchanges from being cut off from emergency services, if Continental's facilities were damaged. The service to Continental was terminated as soon as Continental secured substitute arrangements.

In part because of the fact Northwestern Bell erroneously advised the department that an activity had stopped, US WEST entered into the original CECO agreement.

STATEMENT OF SENATOR PRESSLER

On March 8, 1991 my office received five boxes of documents with no explanation other than the following note. US West had indicated to my staff that an index of what was to be contained in the boxes would be provided. But nothing was provided in the boxes of documents that would assist me in determining the ratepayer impact.

LETTER FROM LAIRD WALKER TO DAN NELSON AND KEVIN SCHIEFFER

MARCH 8, 1991.

DAN NELSON and KEVIN SCHIEFFER
Office of Senator Larry Pressler, 133 Hart Senate Office Building, Washington, DC 20510

DAN AND KEVIN: Per our conversations, here are the Department of Justice logs of the US WEST investigation which I promised you. Please be sure to call me if you have any questions or need further information.

STATEMENT OF SENATOR PRESSLER

Subsequent attempts to obtain pertinent information to the central question were frustrated. Using its own definition of "ratepayer impact," US West determined that none existed. Still, my question on the investment of ratepayer money remains unanswered.

LETTER FROM RICHARD D. MCCORMICK TO SENATOR PRESSLER

MARCH 8, 1991.

The Honorable LARRY PRESSLER,
U.S. Senate, 133 Hart Senate Office Building,
Washington, DC 20510–4101

DEAR SENATOR PRESSLER: Enclosed please find the initial response to the second set of questions you asked in your letters to me of February 26 and 28, 1991.

It is taking us longer to answer this set of questions because under normal regulatory accounting procedures no special accounts are created for activities such as these. As a result, we now are deriving the data retroactively. The attached information was developed from a variety of sources, including product managers' data, special studies and extrapolations based on sample periods.

As a result of the way these data were derived and the speed with which we compiled them, I would classify them as preliminary. We are continuing to study the activities and to refine the data to reflect their impacts on ratepayers as accurately as we can. I will provide you with another report on March 15.

I have divided the attachments to this report into two sections. The first one deals with the revenues and expenses—by jurisdiction—of the four activities that we admitted were technical violations of the Modification of Final Judgment. You will note that for two of the activities—Provision of Computer Facilities Management Services and Operator Workstations—there are no ratepayer impacts. These activities were carried out by unregulated subsidiaries and the expenses for them were not charged to ratepayers, but may have affected shareowners.

In order for a business activity to affect ratepayers, two circumstances must occur.

First, the activity would have to either make money or lose money in a given jurisdiction during a given time period.

Second, a ratemaking proceeding in that jurisdiction must have used that period of time as a "test year" for ratemaking purposes.

So, for Provision of switch Service to GSA, you can see that there was potential for ratepayers in four states and the federal jurisdiction to have been affected, but any effect would have been positive. Likewise, for Provision of Reverse Directory Services, you can see that there was potential for ratepayers in all states and the federal jurisdiction to have been affected negatively.

As for the second group of activities, I'd like to restate our assertion that we never engaged in some of them. As for the rest, we assert they weren't violations of the Decree and the Department of Justice acknowledges that it did not conclude they violated the Decree. In this respect, I regard these other nine activities as part of the process of developing new products and services, some of which fail and some of which succeed. This is a normal function of doing business.

Again, in the cases where there are no impacts listed, the activities either were never undertaken by in US WEST or were undertaken by unregulated subsidiaries and there would have been no impact on ratepayers, but may have affected shareowners.

I hope this initial response to your questions is satisfactory.

Very truly yours,

RICHARD MCCORMICK.

LETTER FROM RICHARD D. MCCORMICK TO SENATOR PRESSLER

MARCH 15, 1991.

The Honorable LARRY PRESSLER,
U.S. Senate, 133 Hart Senate Office Building,
Washington, DC 20510–4101

DEAR SENATOR PRESSLER: Enclosed please find our detailed response to the second set of questions you asked in your letters to me to February 26 and 28, 1991.

As I told you in my March 8 letter, the earlier data were preliminary. The report that follows is arranged in the same manner, but some of the footnotes to the tables and some of the data in the tables are different.

In general, the differences are: First, we have further refined our analysis of the impacts of Provision of Switch Service to GSA and Reverse Directory Services on the intra- and interstate jurisdictions. Second, the expense figures for Provision of Reverse Directory Services are larger. (I should note here that the changes in these expense figures on the tables represent the net effect of several adjustments we've made to the data.) There are no changes to the data concerning the nine services that we assert did not violate the Modification of Final Judgment.

Finally, the data in this package conform to the data we are supplying to the FCC, which made some similar data requests.

I hope these responses to your questions have been satisfactory. I am sorry we couldn't work out arrangements to meet in Washington this week. I was set to come in Thursday. However, I will be in Washington on Tuesday and Wednesday, March 19 and 20, and would be pleased to meet with you concerning your requests and our responses if we can agree on a mutually convenient time.

Very truly yours,

Richard McCormick.

Any impact on ratepayers pertaining to the activities included in the Department of Justice settlement would apply only to the services provided by the regulated telephone companies, e.g., switched services to the GSA and reverse directory services. Ratepayer impacts would be limited to the inclusion of the related revenues, expenses and investment in rate setting activities. Any investment continues to be part of the rate base and is utilized in providing ongoing telephone services to the company's customers (ratepayers).[1]

LETTER FROM SENATOR PRESSLER TO MR. RICHARD MCCORMICK

MARCH 15, 1991.

Mr. RICHARD MCCORMICK,
Chief Executive Officer, US West, Inc.,
7800 East Orchard Road, Suite 200, Englewood, CO 80111

DEAR MR. MCCORMICK: just finished reviewing the material you forwarded concerning my inquiry. The five boxes of paper had none of the organization, explanation, or indexing as was previously agreed. Perhaps buried in there somewhere is some relevant information. Perhaps there is not.

I am coming to recognize the frustration experienced by those who have in a much more comprehensive manner than I attempted to get answers to questions on ratepayer impact and anti-competitive behavior. I don't want to prejudge at this stage. I am quickly getting a sense of the frustration expressed by Judge Green when he noted that, "it is inescapable from this almost three-year history that US West has been engaged in a systematic and calculated effort to frustrate the Department's legitimate demands for information, frequently by patently frivolous and usually dilatory maneuvers." I hope that is not what is starting here.

Perhaps it is simply a difference of opinion. But none of the information supplied answers my central question concerning ratepayer impact. By your very narrow definition of effect on ratepayers I am not surprised to see why you would feel there is little impact on ratepayers.

By ratepayer impact I mean to include any regulated companies, their employees, and assets involved from the time of development to the conclusion of any activities admitted to be illegal or investigated as such. I would appreciate a total impact figure and the amount of reimbursement to ratepayers for the expenses they incurred in any activity under question. My concept of ratepayer impact is based on the philosophy enunciated by Judge Green when he said, "to the extent that these companies perceive their new unregulated businesses as more exciting and more profitable than the provision of local telephone service—as they obviously do—it is inevitable that their managerial talents and financial resources will be diverted."

I have directed Dan Nelson of my staff to meet with your representatives in an attempt to obtain a better understanding of the information we requested. I hope that will achieve meaningful results, and look forward to meeting you as soon as we receive an answer to my original question.

Sincerely.

LARRY PRESSLER,
United States Senator.

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[1] Privileged and Confidential Advice of Counsel submitted by Mr. McCormick was not reproducible.

LETTER FROM RICHARD MCCORMICK TO SENATOR PRESSLER

MARCH 18, 1991.

The Honorable LARRY PRESSLER,
U.S. Senate, 133 Hart Senate Office Building,
Washington, DC 20510

DEAR SENATOR PRESSLER: I would like to review the events that have transpired since US WEST received your letters of February 26 and 28, 1991. Your letter of February 26 asked US WEST to provide:

1. A detailed description of the four admitted violations and the nine other allegations which were dropped, including all documents submitted by US WEST to the Department of Justice throughout the investigations which characterize the violations and allegations set out in the enforcement order.

2. Information on whether any of the admitted or alleged improper activities involved the funds or personnel of US WEST's regulated telephone companies, including data on costs attributable to regulated investments and expenses in the Federal and each state's jurisdiction.

3. A listing of all disciplinary action taken or planned against the officers and employees of US WEST who are responsible for these offenses.

On March 4 and 15 US WEST provided to you detailed responses to your questions. On March 8 US WEST delivered to Kevin Schieffer of your staff all of the documents he requested. Responses to your questions are summarized:

Detailed Descriptions and Documents Provided to the Department

On March 4 US WEST provided you with a detailed description of the 13 business activities that were part of the agreement with the Department of Justice.

Kevin Schieffer of your staff indicated that he did not want US WEST to deliver the 900 boxes containing 1,450,000 pages of documents that US WEST had submitted to the Department of Justice. Associated with each box is a log and transmittal letter that Schieffer requested and was provided on March 8. I did note in my letter of March 4 that the logs of the documents submitted by US WEST to the Department did not describe or index the documents themselves contained in the 900 boxes.

Data on Costs Attributable to Regulated Investments or Expenses

On March 4, and then on March 15, US WEST provided you with data on the costs attributable to regulated investments and expenses in the Federal and in each state's jurisdiction for the 13 business activities. The data includes the involvement of the telephone company's employees and assets from the time of development to the conclusion of the activities.

For nine of the activities—Computer Facilities Management Services, Operator Workstations, GSA sales to Seattle, Provision of Switch Service to GSA, FTS 2000, Talking Yellow Pages, Payphone Sale Practices, and Cellular Credit Card Phones—there were no adverse impacts on ratepayers.

For the two activities that were admitted violations—Provision of Switch Service to GSA, and Provision of Reverse Directory Services—the total costs attributable to both the Federal and state jurisdictions were: Revenue: $6,368,989; Expense: $8,503,475; Gross Investment: $4,655,735; Equivalent Employees: 38.

Three activities of the nine that the Department dropped from consideration, had costs attributable to the regulated telephone company—VuPoint, Tape Data Stacking Utility and One-Call Notification Service. The total costs attributable to the regulated telephone companies were: Revenue: $200,783; Expense: $2,038,377; Gross Investment: $1,740,000 Equivalent Employees: 23.

Regarding the state of South Dakota, only Provision of The Reverse Directory had costs attributable to the intrastate operations of US WEST Communications (formerly Northwestern Bell). Those costs were: Revenue: $7,670; Expense: $25,580.

None of the other 12 business activities had any costs attributable to US WEST Communication's intrastate Operations in South Dakota.

The last US WEST Communications rate case in South Dakota concluded in July of 1985. The rates that our customers have paid in South Dakota have never included expenses or investments attributable to any of the 13 activities in question.

As I noted in my letter of March 4, the four admitted violations were the subject of vigorous debate between US WEST and the Department for varying periods of time. In other words, the violations resulted from differing interpretations of the Modification of Final Judgment. It's my feeling that the employees involved were acting in good faith and were executing their responsibilities conscientiously. Therefore, we have not disciplined any employees in these matters. The other nine activi-

ties we deny were violations and further, assert that we never even engaged in some of them.

In each of my letters (February 26, March 4, and March 15) I offered to discuss this issue. I offered to meet with you in Washington on March 6 and 14, but your staff was unable to confirm a definite time. I will be in Washington on March 19 and 20, and if a mutually convenient time can be arranged, would like to discuss this matter with you.

In the fourteen business days since US WEST received your February 26 letter, more than 40 people have spent over 1,000 hours preparing our detailed response to all of your questions and delivering all of the documents that you requested. I believe we have satisfied both the letter and the spirit of your request.

Very truly yours,

RICHARD MCCORMICK.

STATEMENT OF SENATOR PRESSLER

US WEST has yet to address the central question affecting ratepayers. I shall continue trying. Through this exercise I learned the kind of frustration that Judge Green expressed when he said, "It is inescapable from this almost three-year history that US West has been engaged in a systematic and calculated effort to frustrate the Department's legitimate demands for information, frequently by patently frivolous and usually dilatory maneuvers."

I hope they will be more forthcoming in the future.

LETTER FROM SENATOR PRESSLER TO RICHARD MCCORMICK

MARCH 18, 1991.

Mr. RICHARD MCCORMICK,
President, US West, Inc., 7800 East Orchard Road, Suite 200, Englewood, CO 80111

DEAR RICHARD: I have received your letter of March 18th. I am very disappointed at the lack of a direct response to my central question concerning ratepayer impact. Your March 18th letter ignored my letter of March 15th. Let me restate for the record the areas in which I feel your response is lacking:

1) The specific information I requested concerning ratepayer impact on all thirteen activities remains unanswered. As described in my letter of March 15th, your definition of the effect on ratepayers is unreasonably narrow. The question I had is restated in the March 15th letter, which I think more reasonably defines ratepayer impact.

2) Contrary to your letter of March 18th, the requested documents were not delivered to my office. There is no letter with each box explaining the documents contained therein. In fact, as stated in my March 15th letter, nothing in the information received earlier provides useful guidance to the five boxes of paper.

3) Your March 18th response narrowed the scope of my original inquiry not only by your unreasonably narrow definition of ratepayer impact, but also by the number of activities you addressed. I would appreciate a response to my original inquiry.

Dan Nelson of my staff has contacted your office seeking this information. We look forward to your reply.

Sincerely,

LARRY PRESSLER,
United States Senator.

LETTER FROM SENATOR PRESSLER TO MR. ALFRED C. SIKES

MARCH 7, 1991.

The Honorable ALFRED C. SIKES,
Chairman, Federal Communications Commission,
1919 M Street, NW, Washington, DC 20554

DEAR MR. CHAIRMAN: I appreciated your testimony at last week's Senate Communications Subcommittee hearing on S. 173, a bill to permit the Bell Operating Companies to manufacture and.provide communications equipment. As always, you gave a clear and thoughtful presentation of many complicated issues.

At this hearing, Mr. James Rill, Assistant Attorney General, Antitrust Division of the U.S. Department of Justice, indicated that he was confident that the US West

telephone companies and their employees had been engaged in activities that were' under investigation by the Department of Justice.

I am concerned about the impact that these US West activities may have had upon US West telephone ratepayers. I would like you to examine the activities that were reviewed by the Department of Justice and to respond to the following questions:

1. How were rate-regulated US West telephone companies and employees involved in the activities that were investigated by the Department of Justice?
2. To what extent did these activities have an impact upon US West's telephone ratepayers?
3. What actions, if any, are you considering to remedy any harm to ratepayers that may have resulted from these activities?

I ask that you coordinate this investigation with the Department of Justice. I look forward to receiving your response to these questions by March 14th and will include them in the record of last week's hearing.

Sincerely,

LARRY PRESSLER,
United States Senator.

LETTER FROM MR. ALFRED C. SIKES TO SENATOR PRESSLER

MARCH 18, 1991.

Honorable LARRY PRESSLER,
Subcommittee on Communications, Committee on Commerce, Science, and Transportation, U.S. Senate, 133 Hart Senate Office Building, Washington, DC 20510

DEAR SENATOR PRESSLER: Thank you for your letter regarding the activities of US West that were investigated by the Department of Justice for possible violations of the Modification of Final Judgment (MFJ). We have reviewed with Justice officials the Department's extensive investigation into 13 activities of US West, including the four activities which US West has admitted were MFJ violations. We have focused in particular on the concern you expressed about whether these activities had any impact on US West telephone ratepayers.

The four activities that violate the MFJ were 1) the provision of computer facilities management services; 2) the manufacturing of operator work stations; 3) the provision of private line switching services to the General Services Administration; and 4) the provision of reverse directory services. The computer facilities management activity was conducted by a non-telephone company subsidiary of US West and, based on our review to date, appears to have had no impact on US West's telephone ratepayers.

Similarly, the manufacturing of operator workstations was conducted by a non telephone subsidiary and appears to have involved no telephone company employees. Although that subsidiary did sell some operator work stations to a US West telephone company, it does not appear that these sales had any impact on US West telephone ratepayers. The total amount of the sales was relatively small—$133,000—and the pricing appears to have been in compliance with FCC rules for transactions between a regulated telephone company and a non-regulated affiliate.

The other two admitted violations, i.e., the provision of switching services to the General Services Administration and the provision of reverse directory services, were conducted by US West telephone companies, not by other subsidiaries of US West, and involved telephone company employees. According to US West, the GSA activities were profitable, though the reverse directory service apparently lost approximately $3 million during its brief period of operation. We plan to continue our review of those activities involving the latter two MFJ violations to determine whether they adversely affected US West ratepayers.

The other nine activities involving possible MFJ violations were not investigated to completion by the Department of Justice. Two again were conducted by non-telephone subsidiaries and appear to have had no impact on telephone company employees or ratepayers. The other seven activities were conducted by US West telephone companies. One of those activities, the VuPoint polling service, appears to have suffered losses of approximately 5.5 to 2 million between 1987-89, according to US West. We plan to review further each of those activities to determine whether they adversely affected US West's telephone ratepayers.

We will continue to examine these activities by US West. In addition to the enforcement action taken by the Department of Justice, the FCC has ample authority to take independent enforcement action and to further ensure that, if any ratepay-

ers are damaged, they can be made whole. We would be pleased to keep you and the Subcommittee informed on our progress.

Sincerely,

ALFRED C. SIKES,
Chairman.

LETTER FROM JAMES F. RILL TO SENATOR PRESSLER

MARCH 15, 1991.

Honorable LARRY PRESSLER,
U.S. Senate,
Washington, DC 20510

DEAR SENATOR PRESSLER: During the hearing held on S. 173 by the Subcommittee on Communications on February 28, 1991, I promised to provide additional information, consistent with the Department's confidentiality obligations, on the four admitted US WEST decree violations and nine other US WEST decree compliance matters covered by the Department's recent $10 million civil penalty settlement entered by the U.S. District Court for the District of Columbia. I enclose a summary we have prepared of these 13 matters that I hope will be informative. Also enclosed is a body of correspondence and other related materials concerning the matters described in the summary. I hope these materials and the summary will be useful to you and to the other members of the Subcommittee. The summary and the other materials that I am enclosing are necessarily somewhat technical in nature. Therefore we will be glad to go over these materials with you if that would be useful.

At the hearing, you also requested general information regarding the Department1s other pending investigations of MFJ compliance. I also enclose a summary we have prepared of these investigations that I hope will be useful and informative. Again, we will be glad to further explain the technicalities of these matters if such would be useful.

You also expressed particular concern at the hearing about the possible effect on ratepayers of decree violations by in US WEST. As I noted at the hearing, the order entered against in US WEST in the Department's MFJ proceeding expressly provides that no part of the $10 million penalty imposed on in US WEST may be recovered from ratepayers. The Department does not regulate in US WEST rates; such regulation is under the jurisdiction of the FCC and state authorities. We have, however, been consulting with the FCC regarding the concerns you expressed at the hearing and have made available to the FCC materials provided to the Department by US WEST. We will continue to assist the FCC in providing the information you have requested as soon as possible.

I appreciate very much your interest in the Department's decree compliance efforts.

Sincerely,

JAMES F. RILL,
Assistant Attorney General.

SUMMARY OF THIRTEEN US WEST MFJ COMPLIANCE MATTERS COVERED BY $10 MILLION SETTLEMENT

The following is the Department of Justice's summary of the 13 US WEST matters covered by the $10 million civil penalty settlement entered by the U.S. District Court for the District of Columbia.

1. GSA

US WEST, through Mountain Bell and US WEST Information Systems, Inc., replaced AT&T's switching services for the government1s private telephone network in four cities: Denver, Colorado; Albuquerque, New Mexico; Phoenix, Arizona; and Salt Lake City, Utah. In doing so, US WEST engaged in discriminatory pricing in its charges to GSA for access to Mountain Be111s local telephone network and for certain lines to connect switches used in conjunction with Mountain Bell's switching services. By such discriminatory pricing, US WEST engaged in conduct contrary to the provisions of section 11(B)(3) and Appendix B of the MFJ.

2. Reverse Directory Services

US WEST provided electronic reverse directory services. Using this service, a customer provided a telephone number and US WEST then provided either the name or the address associated with that number. While BOCs can provide the traditional "white pages" in order to assist users in making telephone calls, they cannot provide

any additional or related information without a waiver or they have offered a prohibited information service. In addition, because the service was provided throughout a BOC's region, the interexchange telecommunications prohibition would be violated, absent a waiver.

The Department has twice concluded that US WEST has been offering reverse directory services in violation of the decree's information services restriction and written three enforcement letters to US WEST informing it of our views and instructing it to cease the services. The first service we learned of was "Addressline," offered by Pacific Northwest Bell. The customer supplied the telephone number and the PNB operator gave the customer the name or address and zip code. On June 25, 1985, and on March 28, 1986, we told PNB this violated the decree in letters to PNB's General Counsel. The June letter sets forth the Department's reasoning. After US WEST received the letter, it responded that the service was a permitted directory assistance service. A meeting between the Department, US WEST and other BOC representatives occurred in July 1985. The BOCs argued that they believed they could provide the service. One BOC, Ameritech, pointed out it had been providing the service for over 30 years. (In June of 1986, Ameritech sought a waiver to provide the services, which was granted in February of 1989.)

In August 1986, we received a complaint from MCI that all three US WEST companies were offering "Scantel," a reverse directory service. Scantel was a service that was developed in Mountain Bell and later provided by all three operating companies. Scantel was offered as follows: a customer with a personal computer could access (over telephone lines) a US WEST data base other than its directory assistance data base.

In November, after the MCI complaint, US WEST lawyers met with the Department. In May 1987, the Department wrote a letter to US WEST ordering that Scantel be terminated. All three companies shut down Scantel in July of 1987.

In about June 1987, we received information that US WEST's PNB subsidiary was offering another reverse directory service, "Accusource." This service was provided in a different manner. A customer sent a magnetic tape with a list of information needed; PNB would update the tape and return it.

3. ACI

Applied Communications, Inc. ("ACI") was acquired by US WEST in 1986. ACI is a software company that makes software for transaction processing, primarily for electronic funds transfer systems. US WEST was able to acquire ACI under the "software" waiver.

While ACI, as a US WEST company, can be in the software business, ACI, however, was doing some processing related to a contract it had with ARCO to provide "facilities management." Under this contract, it provided hardware, personnel and other support to operate ARCO1s computer and debit card system. The system allowed customers to debit directly their bank accounts for purchases at ARCO gas stations. Transactions from ARCO stations were sent via telephone lines to a computer center for immediate approval or were sent to local bank networks for processing. Files at the computer site operated by ACI were updated daily, and the transaction information was sent to the banking institutions at the end of each business day. Such processing is an information service, prohibited by section 11(D)(1) of the MFJ.

In April of 1986, US WEST notified the Department that the company planned to purchase ACI and indicated that it would be involved in a review of its activities. In May of 1986 in US WEST told the Department that ACI was not engaged in any prohibited activities. In November 1987, US WEST reviewed ACI's contractual commitments and determined that the ARCO arrangement violated the MFJ. On November 20, 1987, US WEST and the Department stipulated to a Civil Enforcement Consent Order that created new procedures for review of in US WEST activities that might violate the line-of-business restrictions and new procedures to train in US WEST employees to comply with the MFJ. (See item 13, below.) In November another complaint was made to the Department about the service. In February 1988, prior to any Departmental investigation, in US WEST voluntarily stopped providing the service to ARCO.

4. KEI

In 1986, US WEST bought a company called Knowledge Engineering, Inc. ("KEI"), which had developed a workstation that increased the efficiency of telephone operators providing directory assistance and call assistance services. Over time, KEI designed and developed new versions of its operator workstation product tailored to specific uses and telecommunications switches and data bases.

In June of 1987, the Department learned of KEI's activities and asked for an explanation of its conduct. US WEST responded on June 22. We asked for additional information in December of 1987 and then met with in US WEST in March of 1988. US WEST argued that because the principal component of the workstation was software and the other components were "off-the-shelf" parts, it was authorized under its software waiver to develop and sell the product. It also argued that the sale of the off-the-shelf parts was covered by its office equipment waiver. Finally, it argued that its activities were not manufacturing, because it did not fabricate the computer workstations, but merely assembled the off-the-shelf components. The Department concluded that while in US WEST did not fabricate the workstation, it did develop mechanical drawings of an interface card used to connect the workstation to the switch in the network, and it further developed operative prototypes. In August 1988 we asked for additional information. On April 18, 1989, we issued a visitorial letter. US WEST responded by producing three quarters of a million pages of documents.

On May 2, 1989, the Department informed in US WEST that KEI's activities violated both the manufacturing prohibition and the prohibition on providing telecommunication equipment (because the equipment was sold to telecommunications carriers). US WEST stopped the activities on May 19, 1989.

USA Sales to Seattle (Other than DAPs)

In January 1987, US WEST Information Services and Pacific Northwest Bell were involved in developing a proposal to provide electronic tandem switching for the FTS network in Seattle, Washington. The sale was part of a GSA procurement of new switching services in 14 cities across the country. PNB proposed that the service be provided using a digital switch to do the tandem switching. The local switch, however, was to be an analog switch, which meant that hardware facilities would have been necessary to connect the local switch to the tandem switch. PNB decided not to bill for the connecting facilities between the machines, but to "impute" the costs of those facilities into its price for switching services.

This strategy was apparently controversial because it could be viewed as discriminatory, since AT&T and other customers were being billed tariff rates for functionally equivalent interconnection facilities. In this regard, a number of individuals within US WEST expressed serious reservations about the legality of PNB's decision, given the MFJ Court's November 26, 1986 Order finding that US WEST's pricing practices in the earlier sale to GSA were discriminatory. PNB attorneys, however, took the view that the November Order did not obligate PNB to bill for the intermachine facilities. Rather, they asserted it only obligated PNB to ensure that the costs of providing the service were included in PNB's evaluation of the costs of providing the switching service. This concept was known as "imputation."

6. Provision of Switching Services to GSA

This matter relates to the GSA investigation, listed above in item 1. It involved the issue of whether US WEST had complied with the MFJ Court's order of November 26, 1986. That order was issued after AT&T petitioned the Court for an order declaring that US WEST's methodology for pricing switching services in Denver, Albuquerque, Phoenix, and Salt Lake City constituted discrimination in violation of the decree.

In June 1987, US WEST adjusted its rates. It informed the Department of its action in October 1987 and stated that the reduced switch price lowered its profit, but that the service was still being provided above cost.

7. FTS 2000

In 1988 and 1989, US WEST participated in bids to provide the government a new telecommunication system, which came to be known as FTS 2000. FTS 2000 was to replace much of the federal government's telecommunications network then in place with more technologically advanced switching devices and additional functional capabilities. US WEST was to provide certain switching services to one of the companies submitting a bid to the Federal Government, Martin Marietta. That company, however, did not receive the contract.

8. Talking Yellow Pages

In 1985, US WEST's PNB subsidiary offered a talking yellow page services called "Telequest." With this service, the customer called a local 7-digit number, asked for a store or restaurant and received a customized announcement. On June 25, 1985 and on March 28, 1986 we wrote US WEST stating that this service was a prohibited information service and ordered US WEST to stop it. US WEST stopped the Telequest service, as well as another service called Telesource offered by Northwestern Bell, on April 10, 1986.

In 1987, the Department learned that US WEST was offering another talking yellow pages service called Hello Yellow. US WEST, through its subsidiary US WEST Directory, had a sales agency relationship with Information Express Company ("IEC"), which provided the talking yellow pages service. Hello Yellow was essentially the same service as Telequest, but offered indirectly through an agent. Department attorneys met with US WEST counsel in May of 1987 and indicated that the practice violated the decree.

9. VuPoint

US WEST Communications offered a service called the VuPoint polling service, a network data collection service used by TV or radio program sponsors to survey audiences for public opinion polls. Respondents would call a number to vote or express views (e.g., call 555-0000 to vote yes; 555-9999 to vote no). US WEST received the calls from the audience, counted them, and delivered them to the customer. The service was terminated in early 1989.

The Department issued a visitorial letter on October 27, 1988 and received eight and one-half boxes of documents. Our concern was that VuPoint was a prohibited information service.

10. Tape Data Stacking Utility

US WEST's Mountain Bell subsidiary developed a data storage software system for itself called Tape Data Stacking Utility or "TDSU". After completion of the system, employees believed that it would be commercially viable and began to market it to companies that were not telecommunications carriers. At the time, a Bell Operating Company was only permitted to engage in exchange or exchange access Services. A BOC was prohibited under the "catch-all" provision of section 11(D)(3) from providing any service not authorized by the decree. The catch-all provision was removed from the decree in September 1987, almost 4 years ago. The Department learned of this activity when the company that had entered a sales agency agreement to sell the service, Alltran, Inc., complained that its agreement had been wrongfully terminated. We issued a visitorial letter on October 27, 1988 and received about 1,000 pages of documents.

11. Payphone Sales Practices

The Department received a complaint in June of 1988 from Telematic Corp. that US WEST was favoring AT&T as a long distance carrier when it was trying to sell payphones to various premises owners. Specifically, Telematic indicated that US WEST was suggesting, as part of its marketing pitch, that if the customer installs the payphone and then subscribes to AT&T's long distance service, he will receive a portion of the long distance revenues. In May 1989, the Department sent US WEST a visitorial letter relating to its payphone practices, and received 11 boxes of documents.

12. Cellular Credit Card Phones

In 1985 US WEST entered into an agreement with OKI Telcomm, Inc. under which OKI was to develop, design, engineer, manufacture, assemble, and/or service a credit card accessible phone. The activity began in late 1985 and terminated in mid-1987. We issued a visitorial letter on May 2, 1989 and received three boxes of documents.

13. One Call

One call notification systems involve the provision of a single telephone number for excavators to call in order to notify various utilities of their intent to excavate in a particular geographic area. The one call center was acquiring and storing information concerning the location of underground facilities such as telephone, gas, power, and services in US WEST's computer facilities. This creation of a data base and transmission of the information it contained over telecommunications lines is prohibited by the information services restriction.

In 1986 and 1987, US WEST, through Northwestern Bell, provided this service in Nebraska, North and South Dakota, and Minnesota. In fact, the service continued for some time after January 14, 1987 when the Department ordered US WEST to discontinue it. In subsequent months, the Department undertook an exhaustive investigation of the activity, including sending US WEST a visitorial letter and taking a number Of depositions. Eventually, the investigation was settled with the filing in November 1987 of a Civil Enforcement Consent Order. That order created new procedures for review of US WEST activities that might violate the line-of-business restrictions and new procedures to train US WEST employees to comply with the MFJ, and provided for the payment of civil damages for violations of its terms. It was entered by the Court on February 2, 1989.

SUMMARY OF PENDING MFJ COMPLIANCE INVESTIGATIONS

The Department receives numerous complaints of alleged violations of the MFJ. When a complaint is made, we routinely ask the BOC to justify the service or action involved under the decree. After reviewing the BOC's response, we decide whether to pursue the complaint with an investigation. The following are summaries of the matters that the Department is currently investigating:

1. A BOC allegedly selected the interexchange carrier that was to handle the cellular traffic of users who were obtaining services from a provider in an area other than their own (known as "roamers"). Selection of an interexchange carrier may be an interexchange function that a BOC is prohibited from performing by the MFJ.

2. Providers of operator services complained that the manner in which the BOCs provided billing and collection services for operator services violated the MFJ requirement that BOCs not discriminate. The question is whether the BOCs are treating AT&T differently than they treat other providers of operator services.

3. A BOC subsidiary may have constructed and operated paging facilities that crossed a LATA boundary. A BOC may not provide interLATA services unless it obtains a waiver of the MFJ.

4. Two BOCs were granted an exception to the LATA construction rules to enable them to provide services into "corridors" of territory in adjacent states that they cannot otherwise serve. If the BOCs provided cellular services in those corridors without obtaining waivers to do so, they may have been impermissibly providing interexchange services.

5. BOC provision of certain digital network technology may violate the interexchange services prohibition.

6. A BOC may have engaged in designing customer premises equipment ("CPE") after the Court ruled that design activities were part of "manufacturing" that BOCs may not do under the exception to Section 11(B) of the MFJ that permits the BOCs to "provide", but not to "manufacture", CPE.

7. Under the Plan of Reorganization developed by AT&T to implement divestiture, some of AT&T's facilities continue to be located in buildings owned by the BOCs. Certain of those co-locations have been challenged by competing interexchange carriers; the dispute also involves the FCC.

8. Development of the computer software intrinsic to the operation of a fiber optic network may have violated the conditions of the waiver granted to the BOCs to develop computer software.

9. A BOC allegedly marketed and provided an interLATA 800 service without a waiver, which would violate the interexchange restriction in the MFJ.

10. A BOC allegedly engaged in manufacturing in violation of the MFJ. If the BOC provides computer "firmware"—software that is intrinsic to the operation of a piece of computer equipment—it could be involved in impermissible manufacturing.

Senator INOUYE. Senator Breaux.

OPENING STATEMENT OF SENATOR BREAUX

Senator BREAUX. Thank you, Mr. Chairman. Thank you for convening these hearings.

I had told the distinguished Senator from South Carolina that I chaired hearings this morning in this room and Senator Pressler and I and the one witness and the one person in the audience were the only people here. What a difference an afternoon makes.

Certainly the interest in the legislation that is authored by our chairman that I have joined as a cosponsor is obvious by the turnout and the participation. I am looking forward to hearing from the witnesses, and particularly, quite frankly, interested in hearing the testimony of AT&T.

It seems to me certainly in my State that they are engaged in a campaign of misinformation and downright disinformation about what the chairman's legislation does. In my State, they have called on their employees to reach out and touch this Senator and explain to me how this bill will cost them their jobs.

I find that interesting, because while they are doing that now, some of the bureaucrats in their headquarters in New Jersey and

New York and other places have already touched the people of Louisiana who used to work for them. They have touched them with pink termination slips that were being issued faster than someone could dial a 911 emergency number.

In my own State, the record has been replete over the years with AT&T announcements of workers being dismissed. AT&T to lay off 385 workers, AT&T to cut 16,000 jobs nationally, 57 AT&T workers laid off in Shreveport, 93 additional AT&T workers told they will lose their jobs in Shreveport on May 5, AT&T to eliminate 154 local jobs here in Shreveport.

One firing was held the week of Christmas vacation. When they made their announcement, it was pretty clear what their intent was. AT&T says they will lay off 330 workers at their plant in Shreveport on March 30. Public phones will now be manufactured for AT&T in Taiwan. The latest layoffs will leave the plant with about 2,500 workers from a peak of 7,500 in 1974.

So, Mr. Chairman, if the issue is jobs, as AT&T tells their employees, you are right, it is jobs, and I would just suggest that this Congress and particularly this committee cannot wait until the last communication worker in America is left before we take action on trying to create new communication jobs in this country, because we do have the capacity, we do have the ability, and I think clearly we can craft a mechanism which will be sure that there will be fair competition and that there will not be cross-subsidies and that this legislation that the chairman has offered I think moves us in that direction.

I note other studies that have been done, pointing out five AT&T U.S. plants closing—closing—plus Shreveport, Louisiana, with over 60 percent of the jobs and production capacity, moved to Singapore. It is a jobs issue. The problem is, the current situation is clearly not working. This legislation would ensure that there will be more communication jobs, and they will be American jobs, and I think that is a very laudable goal.

Thank you, Mr. Chairman.

Senator INOUYE. Thank you. Senator Exon.

OPENING STATEMENT OF SENATOR EXON

Senator EXON. Mr. Chairman, thank you very much. I am going to be in and out of these hearings today because I have meetings over in the Armed Services Committee with regard to how we are going to pay for the war in the gulf, and I will be back and forth. I will make a few statements and be back in.

I think this is a very, very important hearing, and just by the opening statements that have been made by my colleagues, it indicates that this matter has generated a good deal of heat.

I would first say, I am not sure, whatever the decisions made on this particular legislation as introduced by Senator Hollings, the one main beneficial part of this bill is that theoretically it is going to produce more jobs or else stop the loss of jobs overseas. That is the one redeeming part of the bill that I am somewhat attracted to.

However, I have some questions overall on this, as we proceed. I am not sure that this is the time for an all-out war over which

of these two super giants—either AT&T or the regional Bells—are going to make the most products in America.

Maybe this is the time to recognize once again and state that there is a flight like never before of jobs from America abroad, and I predict that that will be enhanced significantly if the President and his administration is successful with the free trade zone with Mexico.

If you are worried about the flight of jobs to Taiwan and Singapore and Hong Kong and South Korea, just wait when they can fly a little bit faster and bring the products back a little bit cheaper with the cheap labor market in America.

So, as much as anything else, I think what we are debating here—and there is a legitimate debate, and most of it I think if I were an operator of AT&T or an operator in one of the regional Bells I would be very much involved in this process, because it is a struggle that is going on.

I will eventually vote on this matter what I think would be in the best interests of the people and the workers of the United States that I think are being absolutely crucified with the flight of jobs overseas for one reason, and that is the exploitation of cheap labor, so as much as anything else this matter is all about cheap labor and how we are going to keep some of that labor in the United States.

I will be asking a question, and I would like at this time, Mr. Chairman, since I might not be back at the time that it will be opportune to ask this question, I would like to have the question asked of the regional Bells as to what their position is and what they think of the recent happening in New York, where the New York Public Service Commission has attempted to increase competition for local access services by establishing rules that will allow competitive local access service providers to interconnect with the Bell operating company network through allocation and connection with the BOC central offices.

Senator INOUYE. Senator Burns.

OPENING STATEMENT OF SENATOR BURNS

Senator BURNS. Thank you, Mr. Chairman. I am also very thankful that you did not call on me to follow our chairman of the full committee. He is a tough act to follow.

I want to take this opportunity to commend the committee chairman, full committee, for Senator Hollings for making this communications the top Commerce Committee issue. And also, Senator Inouye, the subcommittee chairman who has so speedily moved these hearings along. Because I think as we go through this year, the 102d Congress, we are going to see many pieces of legislation that will deal with the infrastructure modernization of communications and this is but the first step.

So, I commend you for this hearing. I am looking forward to hearing the testimony of my good friend, the FCC chairman, Mr. Sikes. And of course NTIA director, Janice Obuchowski. And I would ask unanimous consent so that we can hear these people, that my full statement might be just entered in the record, Mr. Chairman.

As many of my colleagues know, last year I hosted two 3-day telecommunications conferences and demonstrations in Helena and Billings, MO, on "Information Age Technologies and Montana Economic Development."

As far as I am concerned, the two—technology and economic development—are inextricably linked. For my State to prosper, for rural America to survive, and for America to remain competitive in the global economy, the long talked about promise of telecommunications technology and the Information Age is going to have to be realized.

we are today witnessing a transition from an industrial society, in which wealth creation depended on processing of raw materials, to an information society, in which wealth creation will depend on the processing of information. The deployment of a modernized telecommunications infrastructure is the engine that will drive economic development in the Information Age of the 21st century, just as waterway, railroads, highways, and airways were the engines of economic development in the Agrarian and Industrial Ages of the 19th and 20th centuries.

As part of my conferences, a number of telecommunications companies were invited to display their wares. We saw some pretty exciting developments—two-way interactive video and audio distance learning, rural medical applications, like high-definition medical imaging, and emergency systems, to name just a few.

What has become very clear to me, in the short time I have been in the Senate and a member of the Communications Subcommittee, is that the only thing missing is a comprehensive and coherent set of national communications policies to accommodate and spur this telecommunications infrastructure modernization and Information Age revolution.

As a first step in attempting to develop a scheme to spur telecommunications infrastructure modernization, the issue being debated at today's hearing—the issue of MFJ manufacturing reform—is a key piece of the overall communications policy agenda which must be addressed by the subcommittee during this Congress. As many of you know, I cosponsored and voted for S. 1981 last year and I am an original cosponsor of this year's bill, S. 173, S. 173 is the first action this committee should take in putting Congress back in charge of formulating national communications policy. If our goal is telecommunications infrastructure modernization, we should not have an unelected Federal judge making communications policy for the entire country based not on what is best from a communications perspective but what is essentially an antitrust determination.

I want to take this opportunity to thank and commend the distinguished full committee chairman, Senator Hollings, for making communications the top Commerce Committee priority and for his forwardlooking leadership on the issue before us today. I would also like to thank the honorable subcommittee chairman, Senator Inouye, for holding this hearing.

I look forward to the testimony of our distinguished witnesses—in particular, my good friends, FCC Chairman Al Sikes and NTIA Director Janice Obuchowski.

Thank you, again, Mr. Chairman.

Senator INOUYE. Senator Gorton.

OPENING STATEMENT OF SENATOR GORTON

Senator GORTON. Mr. Chairman, while I voted for S. 1981 last year, I admit that I had reservations about permitting the regional Bell operating companies to manufacture telecommunications and consumer premise equipment. Because of testimony that was presented to this committee last year, I was concerned that allowing the RBOC's to manufacture equipment might pose a threat to an already competitive, vibrant sector of the telecommunications industry.

Since last year's hearing, I had sought the advice and opinions of manufacturers of telecommunications equipment from Washington State. Contrary to my fears, the vast majority of the telecommunications businesses in my state favor the passage of S. 173. I would like to submit 10 letters for the record if I may. All of these letters are from Washington State manufacturers who favor passage of this bill.

Senator INOUYE. Without objection.

Senator GORTON. I would like to mention briefly, some of the comments in the letters I received. From Advanced Electronics Applications of Lynwood, and I quote, "The proposed legislation would liberate companies such as AEA to participate in business partnerships with the Bell companies and the design and development of telecommunications equipment."

From LDEC Corp., also of Lynwood and I quote, "Competitiveness cannot and should not be legislated. Our best customer, Boeing, has virtually all of the capabilities, including fabrication of its vendor base and could easily be our most serious competitor. But the potential vendors to the telecommunications industry do not require or desire protection."

From Applied Voice Technology of Kirkland, "We believe the regional Bell operating companies to be an excellent source for outside capital financing and strategic partnering."

From ICOM of Bellview, "S. 173 would enable us to capitalize on the financial strength and the network and customer know-how of the Bell companies like US West. These assets, combined with our manufacturing capability, would enable us to grow our business and add new jobs to the Washington economy."

Mr. Chairman, I believe in listening to my constituents. As these letters indicate, small manufacturers from Washington State clearly support the enactment of this bill. I am, as a consequence, pleased to lend it my support.

Senator INOUYE. Thank you. Senator Packwood.

OPENING STATEMENT OF SENATOR PACKWOOD

Senator PACKWOOD. Thank you, Mr. Chairman, and let me congratulate Chairman Hollings for introducing this bill. Too often Congress is inclined, if we can, to avoid controversial issues. And I assume we could avoid this one forever if we wanted to leave it with the court and never address it. And the time has come to address it. And if there was not a champion that was willing to push it, we never would.

And I support, I think all of the objectives, save one, and that is domestic content, of the chairman's bill, I think the time has come to allow the RBOC's in the manufacturing. I think the competition between them will be good and the competition between them and others that are not BOC's will be good.

I know the danger, I know the arguments about cross subsidization. Lord knows we have heard those so often in a whole variety of matters before this committee, including transportation and others. I am familiar with the argument about freezing out competitors. I think those are issues that if they become serious problems, can be addressed by this committee and met by this committee in some fashion other than saying, we are not going to allow you into manufacturing because we fear these dangers.

I do not know what I will do on final passage with the domestic content provision still in it. I know it has been changed from last year. But I sit there day after day on the Finance Committee, trying to encourage in the GATT negotiations, the elimination of domestic content. We tried to do it in the trade bill of 1989, worldwide telecommunications competition and the elimination of domestic content. And my heart and soul bend in the direction of worldwide competition.

So, I will reserve my judgment until I see where we are at the final end of this bill. But the thrust of it, in terms of allowing the RBOC's into the manufacturing process, I agree with and I again congratulate our megachairman for having introduced this bill.

Senator INOUYE. Thank you. Senator Kerry of Massachusetts.

OPENING STATEMENT OF SENATOR KERRY

Senator KERRY. Mr. Chairman, I am glad we are here and having this hearing. And I think that you and the major chairman, as he is being called, I think that there are questions that, notwithstanding last year's effort, still do remain outstanding. And I think the analysis of the bill is really extremely complex and it represents a major shift in policy.

Its passage, obviously, is going to have long-term consequence on the overall communication structure of the country. And only on one piece of it at a time when other things are happening in other pieces of it that have enormous neutral impact. So, I am glad we are going to have the chance to have yet more hearings and more examination of it.

Senator Hollings' proposal really challenges the basic assumptions on which we have been operating, about the entire telecommunications era, and I think it requires us to think about what the structure of this new era of communication ought to properly be.

The foundation of the chairman's proposal really rests on the assumption that circumstances have, in fact, really changed since the breakup of AT&T. And we are, obviously, all aware of the increased competition. We are aware of jobs going abroad. We are aware of some changes. And advancing product needs are forcing us to consider the rationale of limiting the activities of seven or our largest companies in the country. I think the 7 together are all in the top 35 corporations in America.

And there are improved safeguards so that all of these things, perhaps, ought to be tested against the original justification of the judgment.

On the other hand, it seems to me that while it is clear that some production efficiencies were lost when you broke up AT&T, when you separated the manufacturing from other operations, it is not altogether clear that the gains to both ratepayers and to other manufacturers, who are now competing for the Bell's business, has not been greater. That the gains, in fact, have not been greater than potentially the downside is.

And I think that is an analysis that we have to do. We have to look beyond the interest of the competing companies to the broader interest of both the country and the longer term picture of what the communication structure of the future is going to look like.

And so I think we have to carefully examine the potential upside that unleashing the Bells will bring us, versus the possible downside, as well as we can measure both of those. I have questions about both of those, not resolved on them. But it seems to me that the potential for combinations between one of the regionals and a Siemens, or an NEC, or an Alcatel or somebody, would really conceivably put that combination into something of a position which is not unlike what we broke up originally when AT&T was manufacturing and working with Western Electric and so forth.

And it seems to me that that question has got to be looked at very carefully, notwithstanding the safeguards that are in the bill. And those safeguards about self-dealing and other things, are strong and do make a difference.

I just, personally, am yet to be convinced about that and wonder if the same compelling rationale for open competition and for letting the regionals into the process of design and development as well as manufacturing, for their needs, the same argument could not be met with respect to local exchange competition. I am sure we would meet with a very different response if we suggested that.

So, those are some of the questions I want to ask. I think this is a very important hearing. I am particularly concerned that there is a major revolution taking place in all of the communications industry, including, obviously, the demands of the information system side, which I know you particularly are anxious to proceed outside of here and that is part of the purpose of being here.

What concerns me, Mr. Chairman, and I am very sensitive to your approach on this and again, want to sit with you, but I am worried that we may wind up doing some piecemeal legislating, affecting the interest of segments of the communications industry, which advantages those segments for a certain period of time. Which may, in fact, have long term implications on the overall makeup of this industry as we go into the next century.

And there are huge implications to that, as to all other aspects of the communications industry. And I am not sure I understand all those implications right now, as I sit here. In fact, I am convinced I do not, but hope to before I vote on this. And I think that is a part of what this inquiry is about.

I thank you.

Senator INOUYE. Thank you very much. Senator Hollings and I are very pleased to welcome to our committee proceedings, Senator Kerrey of Nebraska. Would you care to say a few words?

STATEMENT OF HON. J. ROBERT KERREY, A U.S. SENATOR FROM NEBRASKA

Senator KERREY. Mr. Chairman, I appreciate the chance to be with you today. In 1985, as lead Governor for telecommunications policy at the National Governors' Association meeting in South Carolina, I reached the conclusion that we should move expeditiously to eliminate restrictions under the modified consent decree. And I actually lost a battle in South Carolina where the National Governors' Association was meeting in 1985 to make that policy change.

Although I lost that battle, I am inclined to support this legislation as presented.

I would point out, however, that I do retain two points of significant concern. One is that there are monopoly characteristics still in place, with the regional Bell operating companies, the local carriers and with AT&T itself. Although I understand the FCC is trying to develop a response to these monopoly characteristics, I must declare my fundamental distrust of Government's capacity to get that job done and to respond quickly enough to prevent the anticompetitive activity from causing significant damage to the telecommunications industry.

My second concern is that I believe that technology has changed so dramatically over the past 15 years that there really is not much difference today between the major communication industries; that is, broadcast, common carrier, the producers, as well as the publishers. About the only difference left, really, is an ideological distinction that is reinforced by regulation.

I believe that one of the most difficult but important things that we need to do as policymakers is to redefine the objectives of our communications law. Otherwise, what we will allow is simply a continuation of debates on issues such as this where you have one entity trying to protect its market share against another entity with its own market share, both of whom are understandably trying to satisfy the desires of the shareholders for a return on equity. And they will come before us, come before me, and talk about competition. And I appreciate their desire for competition. But nonetheless, I find myself distrustful of their arguments.

So, Mr. Chairman, although I am inclined to support elimination of the restrictions, I believe that we need to be on our guard against what happens when we permit, as we are presently, significant monopoly characteristics in the marketplace. We need to be prepared to ask the question: What should be the objective of the regulation in the first place?

Senator INOUYE. All right, thank you very much. Being a pragmatic politician, I suppose if I were wise, we would take our vote right now. [Laughter.]

But I would hope that all of us will approach this matter with an open mind and have a full and in-depth discussion of this matter before us and come to a rational conclusion.

This afternoon we are most honored to have with us a very distinguished colleague from the House of Representatives, the Honorable Cardiss Collins.

Representative Collins, after serving many years on the Telecommunications Subcommittee, is now the Chairperson of the Commerce Consumer Protection and Competitiveness Subcommittee. She is the first woman to chair that subcommittee. And because of her long association with telecommunications issues, she is extremely familiar with the implications of the measure we are considering this afternoon.

And on behalf of the committee, Madam Chairperson, we are very happy to have you with us.

STATEMENT OF HON. CARDISS COLLINS, A U.S. REPRESENTATIVE FROM ILLINOIS

Ms. COLLINS. Thank you very much, Mr. Chairman.

I would like to thank you, Mr. Chairman, for giving me the opportunity to testify before your subcommittee. It is always a pleasure and an honor to appear before this body.

For many years now, I have worked to see that minority and woman-owned small businesses are given an opportunity to participate in our national economy. As a member of the House Telecommunications and Finance Subcommittee, and as Chairwoman of the Government Operations Subcommittee on Government Activities and Transportation, I use the combined jurisdictions of these panels to work diligently to help ensure equal access to contracts and capital for small, disadvantaged businesses.

One of my largest undertakings was working with U.S. Sprint and AT&T to ensure substantial representation of small businesses in FTS–2000, the multibillion dollar project to upgrade the Federal Government's telephone system.

My interest in SDB, access to business opportunity with the regional Bell operating companies is an outgrowth of my involvement in telecommunications and minority business issues.

Let me say at the outset that I have not made a final decision on support for S. 173—or any measure—to lift the restrictions on the Bell operating companies. However, I want to make clear my interest regarding the legislation and its potential impact on minority and other small, disadvantaged businesses.

My concerns regarding the lifting of restrictions run along two lines. First, I am interested in preserving the supplier and subcontracting relationships that have developed between the Bell operating companies and SDB's, should the restrictions be lifted.

And second, I am vitally interested in forging additional relationships, such as increased availability of venture capital and increased research and development funding for new and existing SDB's.

The breakup of the Bell System, coupled with the deregulation of telephone equipment, created unique opportunities for entrepreneurship. Prior to the divestiture, SDB's found it difficult to contract with the Bell System.

Since then, I am pleased to say, the number of opportunities has increased significantly. The seven regional Bell operating companies are among the largest companies in our country annually buy-

ing more goods and services than virtually any other seven aggregate businesses in our Nation.

To supply the Bell operating companies with telecommunications equipment and services, scores of minority suppliers have gone into business and prospered, since the modification final judgment was put in place. These suppliers include native Americans, Asian Americans, Hispanic Americans, African Americans, and women. They provide equipment, fire and burglar alarm systems, telephone system installation, and scientific and technical services—just to name a few. Dedicated to providing high-quality products and service at competitive prices, they are top-notch and can compete with anyone, when they are allowed to do so on equal footing.

As you consider S. 173 I hope you will carefully review the record of performance and any risk to small and minority businesses such as unfair product pricing and limited access to contracting information if the Bell operating companies are allowed to manufacture.

Along these same lines, should instances of self-dealing and other anticompetitive practices be attempted by the Bell operating companies, they could preclude SDB's from competing fairly with subsidies of the Bell operating companies. Therefore, I concur with you that strong safeguards are essential and should include separate entity requirements for all Bell manufacturing activities as specified in S. 173 as well as the mandate that SDB's and other contractors will be able to sell customer premise and other telecommunications equipment to the Bell operating companies at the same terms and conditions applicable to Bell subsidiaries.

Now my second major concern is in providing added incentives for the Bell operating companies to invest in small business ventures which may arise to meet new business needs created should MFJ restrictions be lifted.

The regional Bell companies represent over one-half of the telecommunications assets in this country. If the manufacturing restriction is lifted it should be commensurate with provisions calling for investment and research, design and development of products manufactured by SDB's, the establishment of venture capital funds, and the creation of joint ventures between the Bell companies and minority entrepreneurs.

I want to commend you, Senator Hollings, for the provisions in S. 173 requiring that the Bell operating companies conduct all manufacturing activity in the United States, using only American-made components, unless a good-faith effort to locate such a supplier should fail.

I urge you too to incorporate provisions along a similar vein regarding small and minority-owned businesses. In addition, I think two key provisions of S. 173 are essential in developing and maintaining the competition that this Congress and the marketplace will demand.

First, the section in the bill calling for equal access to contracting opportunities for manufacturers other than the Bell operating company's own manufacturing affiliate; and second, the section mandating that Bell operating company purchases from their manufacturing affiliate must be done at the open market price.

I cannot stress enough how important an open, competitive bidding process will be to SDB's and other businesses.

Senator Hollings, if there is any way that I can be of assistance to you in addressing these issues I will be happy to do so. And again, I want to thank you, Mr. Chairman, for allowing me to testify this afternoon.

Senator INOUYE. Madam Chairperson, I thank you extremely, very much, for your wise words. Please be assured that we will keep your suggestions and recommendations in mind as we proceed.

The CHAIRMAN. Thank you very much.

Senator INOUYE. We will have to stand in recess. We have a vote pending at this moment.

[A brief recess was taken.]

Senator INOUYE. Our first panel will consist of the Hon. Alfred C. Sikes, Chairman of the Federal Communications Commission; the Hon. Janice Obuchowski, Assistant Secretary for Communications and Information, Department of Commerce; and Mr. James Rill, Assistant Attorney General, Antitrust Division, Department of Justice. Mr. Sikes.

STATEMENT OF HON. ALFRED C. SIKES, CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION

Mr. SIKES. Thank you very much, Mr. Chairman. I am very pleased to be here. Thank you for giving me this opportunity. I have a statement that I would ask for privilege to have placed in the record, and will then deliver a very shortened version of that statement.

Senator INOUYE. All statements will be made part of the record.

Mr. SIKES. Last May when I testified in support of S. 173's predecessor, I emphasized the following points. First, the decree restrictions are outmoded and do not square with today's competitive realities. Second, there are in fact effective regulatory safeguards. Third, this legislative initiative presents a fundamental choice. Are we going to continue to rely on the Federal judiciary to make and implement communications policy? Or on Congress and expert regulatory agencies?

Today, let me state, Mr. Chairman, that current regulatory safeguards are effective. This Commission has been committed to developing and enforcing sound rules to protect competition. These safeguards include computer-based reporting and monitoring systems; new cost-accounting, auditing, and affiliate transaction rules; network disclosure requirements; substantially greater FCC fines and forfeitures authority; incentive-based or price-cap regulation; and of course, there are many "private policemen."

When the cumulative effect of all these safeguards is considered, it is clear that, in fact, there is a very strong deterrent. If there was an absence of potential improper activities, the numerous safeguards and enforcement activities would not exist. The fact that there are fines, as earlier referred to, proves that these enforcement activities are indeed working.

The number and effectiveness of FCC safeguards should also be considered in light of the additional measures which S. 173 proposes. As I will discuss later in my statement, Mr. Chairman, adding new statutory requirements could frustrate the basic goal of this bill, which is more U.S. manufacturing.

We would welcome the chance, Mr. Chairman, to work with the subcommittee and its staff to ensure that the legislation's rules and our rules are in harmony, and that we do not unintentionally create a regulatory morass.

Let me also respond to the contention that permitting Bell companies to manufacture will bring little new strength to the marketplace. I disagree with that contention. Not much more than a decade ago, it was the established telephone industry which was making precisely that argument. Phone companies argued, as each of you will recall, that no one else should be allowed into the equipment or long-distance businesses, because they would not bring anything into the market. Had the FCC or Congress accepted such arguments back then, many companies which are now opposing S. 173 would not be in business, and the American public would have been denied the benefits which competition has since brought.

Protecting firms in an industry from competition is not, and should not, be U.S. policy. Government assessments regarding who will or will not contribute to the market, moreover, almost always carry with them a risk of broad error. They are precisely the kind of Government actions which characterize most of the world's failed, centrally planned economies.

Our policies should not rest on requirements that would-be competitors prove—before they are allowed into business—that they will deliver. It is only the freedom to complete that truly ignites the dynamics of business creation.

However, let me offer several additional thoughts. Smaller companies which might enter into joint ventures, partnerships or teaming arrangements with the Bell companies could gain new financing options. Understandably, some companies already in the market may not be interested in having their smaller competitors gain those new financing options. But I think Congress needs to consider both the potential entrants, as well as the established incumbents.

I think it should also be noted, Mr. Chairman, that small companies overseas are already allowed to team with Bell companies to design and manufacture, as long as it is for foreign markets. Small American companies should have the same freedom to enlist Bell companies' support to compete in the American communications equipment market. They should not be obliged, which seems to have been the case, to look overseas for financial and technology partners.

The current manufacturing restriction has also been construed by the courts to place severe limits on the ability of Bell companies and independent manufacturers to work together to research and design new communications network equipment. Applied to the Bell companies, which represent over one-half the resources of the American telephone industry, such an extraordinarily restrictive approach cannot help the country. So far as we can discern, the United States is the only country in the world that severely restricts the ability of its telephone companies to participate actively in the design and development of new communications equipment.

The manufacturing restrictions foreclose the benefits of cooperative synergy, and they do so at precisely the same time that ad-

vances in the underlying technology promise quantum gains in new customer service options and network development.

Finally, Mr. Chairman, let me address the fundamental public policy choice which S. 173 presents; namely which part of Government should be in charge. I believe strongly that communications policy should be made by Congress, and implemented by expert regulatory agencies.

Sound communications policy entails carefully balancing the diversity of interests that must be developed in a broad context, with open processes, in which all can participate. Certain features of S. 173 continue to be of concern. Certain subsidiary requirements, for example, may limit the beneficial flow of information among service and product development and manufacturing operations.

Strict financial separation requirements, in our view, can be as effective. However, in conclusion, Mr. Chairman, I would like to restate my support for the basics of this proposed legislation. While I might have some reservations, I certainly look forward to working affirmatively with the subcommittee to resolve any concerns.

I would like to commend you, Chairman Hollings, for your efforts in standing ready to provide active assistance. Thank you.

[The prepared statement of Mr. Sikes follows:]

PREPARED STATEMENT OF MR. ALFRED C. SIKES

INTRODUCTION

Thank you for this opportunity to reiterate my support for legislation allowing the Bell companies to engage in, manufacturing and related product development activities, subject to appropriate safeguards.

THREE KEY POINTS

Last May, I testified in support of S. 173's predecessor. At that time, I emphasized the following key points—which remain valid today:

- First, whatever reasons there might have been in 1982 for consent decree restrictions on Bell manufacturing, today's market environment is significantly different. If all the changes which have occurred are taken into account, the conclusion will be reached that the restrictions are outmoded and do not square with today's competitive and regulatory realities.
- Second, one of the major and most significant differences today is that there are, in fact, effective regulatory safeguards—in place and working. The FCC and state commissions have adopted and implemented rules and procedures. Problems should not arise, but, if they do, remedial action can and will be taken. And,
- Third, at the core of this legislative initiative lies a fundamental policy choice: Are we going to continue to rely on the Federal Judiciary to make and implement communications policy, or are we instead going to rely on Congress and expert regulatory agencies, operating under careful congressional oversight?

In my judgment, communications policymaking should be the responsibility of the FCC and Congress, and not the courts.

ADEQUACY OF SAFEGUARDS

Today, let me state, Mr. Chairman, that current regulatory safeguards are effective. This Commission has been committed to developing and enforcing sound rules to protect competition. Claims that the FCC's safeguards are ineffective are badly outdated.

Both in my previous statement, and on other occasions, I have reviewed these safeguards in detail. To summarize today, however, they include:

- Sophisticated, computer-based reporting and monitoring systems. Systems such as our "Automated Reporting and Management Information System" (ARMIS) let us compare one firm's performance with its peers, and compare that with historical trends. This serves as an "early warning" system.
- Stringent new cost-accounting, auditing, and affiliate transaction rules. These prevent both anticompetitive cross-subsidies and ratepayer burdening.

- Network disclosure requirements (ONA). These keep phone companies from leveraging control over essential communications facilities to gain unfair advantage in unregulated equipment markets.
- Substantially greater FCC fines and forfeitures authority—up to $1 million per offense—and a demonstrated willingness to use them, as warranted.
- Many "private policemen"—that is, competitors which can, and do, closely monitor market developments, and provide us with information.
- Incentive-based, or "price cap" regulation, which reduces the chance of anticompetitive cost-shifting.

Deterrence, Mr. Chairman, is always a function of a number of factors. These include the ease of detection, the probability of complaints, the certainty of apprehension, the likelihood of enforcement proceedings, and the severity of any ultimate sanctions.

When the cumulative effect of all these safeguards is considered, it is clear there is in fact a very strong deterrent. Consequently, I believe the Subcommittee can be confident that any risks associated with Bell company manufacturing are both manageable and small.

The number and effectiveness of FCC safeguards should also be considered in light of the additional measures which S. 173 proposes. As I will discuss later in my statement, Mr. Chairman, I do have concerns that our safeguards, plus those which this bill would establish, could place too many restrictions on potential Bell company manufacturing. The result could be to blunt the basic purpose of this legislation—namely, more competitive manufacturing.

In that regard, I would welcome the opportunity to review all of the FCC's rules in detail with the Subcommittee and its expert staff. Perhaps a fuller explanation of our rules on our part would indicate why additional statutory requirements may not be needed.

LIKELIHOOD OF POTENTIAL GAINS

Let me also respond to the contention that permitting Bell companies to engage in manufacturing will bring little new strength to the marketplace.

To begin with, I disagree with that contention as a matter of general policy. Not much more than a decade ago, it was the established telephone industry which was making precisely that argument in an effort to prevent competition with its operations. Phone companies argued—as you and other Members of the Subcommittee will certainly recall—that no one else should be allowed into the equipment or long-distance business because they wouldn't bring anything into the market.

Had the FCC or Congress accepted such arguments back then, many companies which are now opposing S. 173 would probably not be in business. And, the American public would have been denied the benefits which competition has since brought.

Protecting firms in an industry from competition is not and should not be U.S. policy. Government assessments regarding who will or will not contribute to the market, moreover, almost always carry with them a risk of broad error. They are precisely the kind of Government action which characterizes most of the world's failed centrally planned economies.

Our policies in communications and, indeed, throughout the economy, should not rest on requirements that would-be competitors prove from the outset what they might deliver.

BENEFITS OF CHANGE

In this particular context, I believe there would be benefits from changing the consent decree manufacturing restrictions as they have been construed.

For example, smaller companies—which might enter into joint ventures, partnerships, or teaming arrangements with the Bell companies—could gain new financing options. Understandably, some companies already in the market may not be interested in having their smaller competitors gain those new financing options. But I think Congress needs to consider both the potential entrants as well as the established incumbents.

The decree restrictions not only limit the Bell companies. They also restrict the commercial freedom of virtually the entire U.S. communications manufacturing industry—which is prevented from entering into joint ventures with the Bell companies.

I believe that changing the decree's manufacturing restrictions could yield significant competitive dividends in terms of funding and supporting new competitors in the market.

I think it should also be noted, Mr. Chairman, that small companies overseas are already allowed to team with Bell companies to design and manufacture—as long as it is for foreign markets. Small American companies should have the same freedom to enlist Bell company support to compete in the American communications equipment market. They should not be obliged—as seems to have been the case—to look overseas for financial and technology partners.

SYSTEM AND PRODUCT DESIGN AND DEVELOPMENT

The current manufacturing restriction has also been construed by the courts to place severe limits on the ability of Bell companies and independent manufacturers to work together to research and design new communications network equipment—including some kinds of computer software.

If we pursued so restrictive an approach in other fields, airlines would not be allowed to work with aircraft manufacturers to design new planes to meet their specific needs. Mass transit authorities would not be allowed to work with locomotive or rolling stock manufacturers. Electric utilities would be barred from working with generating plant suppliers. And, even the Defense Department would be barred from working with contractors to develop weapons systems which meet their needs.

Applied to the Bell companies—which represent over half the resources of the American telephone industry—such an extraordinary, restrictive approach cannot help the country. For the practical effect is to prevent the companies with great expertise in how the telephone network operates from cooperating with firms with knowledge when it comes to designing and building equipment.

Let me also note, Mr. Chairman, that so far as we can discern, the United States is the only country in the world that severely restricts the ability of its telephone companies to participate actively in the design and development of new communications equipment. Nippon Telegraph & Telephone Company (NTT), British Telecom, France Telecom, Germany's new DBP Telekom, and Bell Canada are free from such extraordinary restrictions. The same is true of AT&T, our largest long-distance carrier. Even where there are limitations and safeguards, moreover, they are not devised and administered by courts.

The current manufacturing restriction forecloses the benefits of cooperative synergy—and it does so at precisely the same time that advances in the underlying technology promise quantum gains in new customer service options. Preventing Bell companies from working with independent manufacturers may also undermine the companion goals of encouraging the development of the public network and improving its efficiency.

RELIANCE ON EXPERT AGENCIES

Mr. Chairman, let me now address the fundamental public policy choice which S. 173 presents—namely, which part of Government should be in charge.

As I testified last May, I believe strongly that communications policy should be made by Congress and implemented by expert regulatory agencies—as it has been in most other regards for many years.

Sound communications policy entails carefully balancing a diversity of interests—including, but not limited to, competitive issues. Communications policy has a direct and immediate effect on many Americans and American businesses. It must be developed in a broad context, through open processes in which all can participate.

Relying on Congress and expert agencies, moreover, makes practical sense. In addition to vastly superior resources, the FCC also has substantial in-house technical, financial, and accounting expertise the Judiciary simply cannot—and should not—hope to match.

A broad national, indeed global perspective; plus superior resources; and technical expertise all add up to substantially greater capability to safeguard the public's interests on the part of Congress and expert agencies.

CONCERNS REGARDING S. 173

Certain features of S. 173 continue to be ground for concern. Rigid separate subsidiary requirements, for example, may limit the beneficial flow of information among service, product development, and manufacturing operations. Strict financial separation requirements, in our view, can be as effective in safeguarding the public interest, without incurring the synergy losses that rigid separate subsidiary requirements can entail.

Placing special domestic content obligations on Bell affiliated manufacturing operations is another concern. Such a statutory requirement would be unique. We believe Bell companies' management should have the same flexibility which their competitors in the competitive equipment business now enjoy.

Finally, I have reservations requiring the FCC to prescribe regulations within the 180 days set forth in the draft statute. Assuming the desirability of such new FCC regulations to begin with, developing them in a conscientious fashion which addresses all of the concerns likely to be advanced probably will to take longer than six months.

CONCLUSION

In conclusion, Mr. Chairman, I support the basic thrust of this proposed legislation. As I testified last year, I believe it represents a fundamentally sound initiative with much public interest potential. While I have reservations regarding certain features of S. 173, we are prepared to work affirmatively with the Subcommittee to resolve concerns. I also commend you, Mr. Chairman, for your efforts, and stand ready to provide whatever assistance which we can.

Senator INOUYE. Thank you very much, Chairman Sikes and may I call on Madam Secretary.

STATEMENT OF HON. JANICE OBUCHOWSKI, ASSISTANT SECRETARY FOR COMMUNICATIONS AND INFORMATION, DEPARTMENT OF COMMERCE

Ms. OBUCHOWSKI. Mr. Chairman and members of the committee. I would also like to request the privilege of submitting for the record my more extended comments.

Senator INOUYE. Without objection, so ordered.

Ms. OBUCHOWSKI. I wish to outline the reasons that the administration of President Bush supports the key elements of this legislation, but raises concerns about provisions dealing with domestic content and domestic manufacturing requirements. The principal goal of the legislation, to permit Bell company entry into manufacturing, subject to effective safeguards, represents sound economic policy.

This action will serve to promote competition, increase U.S. research and development, and open up additional investment opportunities in telecommunications in the United States, while also enhancing U.S. global competitiveness.

The Bell companies are seven major United States firms with substantial resources, both technical and financial, that can be applied to the advancement of the U.S. telecommunications and related high-technology endeavors. These resources should be freed to better serve the American public, which means enabling the Bell companies to participate in the manufacture of telecommunications equipment as an adjunct to their provision of telecommunications services to the vast majority of U.S. citizens.

Elimination of the manufacturing restriction would help promote increased telecommunications research and development in this country. This restriction hampers research and development, not only for the Bell companies themselves, but also other entities desiring to work with them on the manufacture of telecommunications equipment.

Due to the consent decree's artificial definitional boundaries between permissible and impermissible activities, the manufacturing restriction has impaired the ability of the Bell companies to engage efficiently in productive, innovative R&D efforts, either alone or with others.

As an aside I would observe that the colleagues of the Bell companies operating in other nations would not countenance the situa-

tion where a lawyer becomes a part of every scientific research team.

The R&D process is also important for infrastructure development. By impeding the ability of the Bell companies to introduce new telecommunications products and services, the consent decree restriction undercuts a principal impetus for technical advances that can spur improvements in the telecommunications infrastructure.

The goal, therefore, of enhancing U.S. global competitiveness will be furthered by S. 173. In the current commercial environment, where foreign-based firms have captured a significant share of U.S. telecommunications equipment markets, we can no longer afford to restrict the entry of seven of our largest telecommunications companies, and thereby handicap the ability of the United States to aggressively meet this competitive challenge.

In some cases, entrepreneurial U.S. companies have had to turn to foreign-based firms as a source of funding or expertise. Thus, the restriction is also artificially distorting trade and investment flows.

While the administration commends the initiative of Chairman Hollings and the cosponsors of S. 173 in promoting a number of significant U.S. policy goals, it is firmly opposed to the domestic content and the domestic manufacturing requirements.

Imposing such restriction would seriously undermine the administration's fundamental goal of achieving free and open trade in telecommunications equipment both here an abroad.

U.S. industry has had some success recently in increasing exports, with the result that the U.S. trade deficit has fallen from approximately $2.6 billion in 1988 to approximately $790 million in 1990. That is not good enough, but the trend is in the right direction. Including domestic content restrictions in the legislation would give our foreign trading partners a ready excuse to close the door on U.S. manufactured goods at a time when the U.S. firms have begun to turn the tide.

The administration is also concerned that including very specific safeguards in the legislation may ultimately prove to be counterproductive. The imposition of inflexible safeguards may reduce the beneficial effects of Bell company entry into manufacturing. The FCC, under the leadership of Chairman Sikes, has the authority and can be relied upon to establish and enforce the appropriate safeguards governing Bell company manufacturing activities.

Finally, the administration is concerned about the specific prohibition on the ability of the Bell companies to enter joint manufacturing ventures with one another. To the extent that any antitrust issues may stem from such joint ventures, they are better dealt with under the antitrust authority of the Department of Justice.

To conclude, the administration believes that modification of the AT&T consent decree to permit Bell company entry into manufacturing will have a significant, positive effect on the United States telecommunications industry. It is time to resolve this controversy, which has lingered too long in the courts, and to put Congress and the executive branch firmly in the driver's seat of setting the direction of telecommunications policy for this country. Such action will permit U.S. manufacturing companies, including the Bell companies, to concentrate on the contributions they can make to enhance

efficiency, spur competition, and introduce innovations into the now global telecommunications equipment market.

Thank you very much, Mr. Chairman.

[The prepared statement of Ms. Obuchowski follows:]

PREPARED STATEMENT OF MS. JANICE OBUCHOWSKI

INTRODUCTION

Thank you for this opportunity to testify on the issue of potential changes to the AT&T consent decree, and in particular, the proposal embodied in S. 173, introduced by Chairman Hollings on January 14th this year. The Administration strongly supports permitting the Bell companies to engage in manufacturing activities subject to effective safeguards. We therefore commend Chairman Hollings and his co-sponsors for making this legislation a priority in the current session of the Congress. The Administration does have serious concerns about some aspects of the bill—including the provision dealing with domestic manufacturing and domestic content requirements. The Administration opposes this provision as counterproductive, restrictive and seriously undermining U.S. trade interests.

PRINCINAL BENEFITS OF BELL COMPANY ENTRY INTO MANUFACTURING

The Administration believes it is vital that this legislation's principal goal—to permit Bell company entry into manufacturing—should be pursued. This goal represents sound economic policy that would promote competition, increase U.S. research and development (R&D), and open up additional investment opportunities in telecommunications ventures in the United States. Additionally, by fostering an environment where competition flourishes, the legislation will position U.S. companies to be more competitive globally.

We are convinced that entry of the Bell companies into manufacturing will further these important objectives. The Bell companies represent a very significant U.S. resource that could be applied to the advancement of U.S. telecommunications and related high-technology endeavors. The Bell companies now provide local telephone service to approximately 80 percent of the U.S. population, and their assets, in the aggregate, represent a significant component of the country's telecommunications base.

In 1990, the seven Regional Bell companies had $79.7 billion in revenues and $8.5 billion in net income; and, as of year end 1990, they employed approximately 551,114 workers. We believe, that these significant resources should be freed to better serve the American public, which, in our view, means enabling the Bell companies to participate in the manufacture of telecommunications equipment—for purposes of this testimony, I include CPE in that term—as a natural adjunct to their provision of telecommunications services.

BENEFITS OF INCREASED BELL COMPANY R&D

Elimination of the manufacturing restriction will help promote increased telecommunications R&D in this country, and it should also have an impact on related infrastructure development. A 1989 NTIA study found that this restriction hampers R&D, not only for the Bell companies themselves, but also for other entities desiring to work with the Bell companies to manufacture telecommunications equipment. The restriction has impaired both the pace at which innovations are being brought to the market and the overall cost of that process.

The definition of "manufacturing" has been construed by the decree court as permitting the Bell companies to engage in the early steps of the manufacturing process. As a result, they may undertake research that does not involve the design of a specific product, but they may not engage in actual fabrication or product design and development. Pursuant to the decree court's interpretation, the Bell companies have been permitted to define generic product features, but not to determine detailed design specifications. Moreover, the decree court has ruled that software design and development is a prohibited manufacturing function if it involves "software integral to equipment hardware, also known as firmware." The need for constant vigilance in applying these definitional boundaries needlessly injects a cumbersome process into any manufacturing activities relying on Bell company input.

By creating artificial distinctions among steps in the manufacturing process,' the decree has, in effect, rendered the Bell companies free to do "basic research" but not "research and development." This result not only disables the Bell companies from directly investing in product-related innovative activities, but it impedes their ability to contribute constructively to the efforts of independent manufacturers of tele-

communications equipment. The importance of such a contribution is recognized, in fact, by the provision in S. 173 that would permit the Bell companies to engage in close collaboration with any manufacturer with respect to the design and development of hardware, software, or combinations thereof. Such collaboration is integral to the R&D process.

RELATIONSHIP OF R&D TO U.S. INFRASTRUCTURE DEVELOPMENT

Not only did NTIA conclude in its 1989 study that reform of the broad manufacturing restriction is likely to stimulate R&D, but also that such reform could potentially accelerate new service developments. A primary output of the R&D process is the introduction of new telecommunications products and services, which can serve as the underlying impetus to technical advances improving the telecommunications infrastructure. Regulatory barriers to R&D by the Bell companies reduce the potential for these U.S. companies to spur such advances.

GLOBAL COMPETITIVENESS

The Administration supports the bill's goal of enhancing the economic growth and international competitiveness of American industry. We are here today to evaluate the desirability of the manufacturing restriction in view of current circumstances. In the current environment, issues relating to the goal of maintaining and fostering U.S. global competitiveness have become a high priority for U.S. policymakers, both in the Congress and in the Administration.

While domestic companies, including AT&T, have long been the prime providers of telecommunications equipment used in conjunction with U.S. telecommunications networks, foreign-based firms have clearly obtained an increased share of these markets. In this commercial environment, it appears that in continuing to handicap some of our largest telecommunications companies—by prohibiting the Regional Bell companies from entering manufacturing—we are, in effect, handicapping the ability of the United States to meet aggressively the competitive challenge presented by foreign commercial interests.

U.S. competitiveness could be fostered by permitting the Bell companies to serve as a source of "seed" capital for smaller U.S. manufacturing companies, and also to enter joint manufacturing ventures themselves. In some cases, entrepreneurial U.S. companies have had to turn to foreign firms as a source of funding or expertise. Thus, the consent decree restriction is artificially distorting trade and investment flows.

THE ADMINISTRATION APPLAUDS THE INTRODUCTION OF S. 173

The Administration thus applauds the initiative of Senator Hollings and the cosponsors of S. 173 in seeking to eliminate the AT&T Consent Decree restriction on Bell company entry into manufacturing. For the reasons indicated, we support this measure as promoting a number of important U.S. policy goals that are vital to the continued economic well-being of this nation.

OPPOSITION TO THE DOMESTIC CONTENT PROVISION

Nevertheless, we also wish to set out the reasons for the Administration's firm opposition to the domestic manufacturing and domestic content provision contained in the bill. By requiring the Bell companies to manufacture only in the United States, and to use only component parts manufactured here (subject to certain limited exceptions), the legislation would seriously undermine the Administration's fundamental goal of achieving free and open trade in telecommunications equipment markets both here and abroad.

We have seen some success in recent years in increasing exports of U.S. telecommunications equipment, with the result that the U.S. trade deficit in this area has fallen over the last two years, from approximately $2.6 billion in 1988 to approximately $790 million in 1990. Domestic content requirements, like those in the bill, would give our foreign trading partners a ready excuse to close the door on U.S. manufactured goods at a time when U.S. firms have begun to turn the tide. These same trading partners have begun to liberalize their own markets, in certain cases at the urging of the United States. Local content restrictions could give these countries a pretext for reversing these liberalizing moves, further hampering the U.S. export effort.

Moreover, domestic content restrictions act, in effect, as a ban on imports. Such bans deny consumer choice, impose inflationary pressures on the economy, and may unfairly put the Bell companies at a competitive disadvantage vis-a-vis other manufacturers not forced to operate under the same restrictions.

The Administration also has serious questions about the trade policy implications of the domestic manufacturing and domestic content requirements of the bill. This provision raises severe concerns regarding U.S. compliance with our international trade agreements, including the General Agreement on Trade and Tariffs (GATT), the U.S.-Canada Free Trade Agreement (FTA) and bilateral investment agreements. The provision also would undercut our U.S. negotiating position in various on-going negotiations, which are at a critical juncture. We have already been advised by certain of our trading partners that they believe the provision violates our GATT obligations. A finding of such a violation by a GATT dispute panel would obligate the United States to remove the provision or to pay compensation to, or face retaliation from, these trading partners.

SAFEGUARDS CAN PREVENT OR DETER POTENTIAL ABUSE

In weighing the potential benefits of Bell company entry into manufacturing, we have also assessed arguments that there is the potential for anticompetitive conduct due to Bell company control of most local exchange facilities. We agree with the authors of S. 173 that a system of safeguards should meet concerns that the Bell companies might engage in anticompetitive discrimination against competitors, or that they might engage in unlawful cross-subsidies; however, we are also concerned that imposition of unnecessary or inflexible safeguards may also reduce the beneficial effects of Bell company entry into manufacturing.

The authors of S. 173 have crafted a number of safeguards intended both to preserve competition and to protect consumers from the impact of potential abuses. The bill includes, for example, provisions that separate the Bell companies' regulated operations from their manufacturing ventures, prevent Bell company discrimination, and seek to ensure necessary disclosures regarding Bell company networks will be made to competitors. These provisions would be additional to existing FCC regulations applying to Bell company conduct.

While the Administration agrees that additional safeguards may be warranted, including specific regulatory provisions in the legislation creates serious risks. Such provisions may inadvertently create implementation problems due to possible ambiguities and inconsistencies with the existing FCC framework, or they may prove inflexible and difficult to alter over time should modifications be deemed necessary.

We are confident that the FCC can be relied upon to successfully fulfill the task of setting and enforcing any safeguards pertinent to Bell company manufacturing activities. If additional safeguards are needed, the FCC currently has adequate authority to develop appropriate rules and regulations. Any FCC action, of course, remains subject to Congressional oversight, with the potential for the Congress to provide further directions if necessary.

Even under such an approach, however, we are seriously concerned about the concept of specifically prohibiting joint manufacturing activities between or among the Bell companies, which is inconsistent with the bill's emphasis on increasing competition in the CPE and telecommunications equipment markets. To the extent that there may be antitrust issues stemming from such joint ventures, the Department of Justice has the necessary authority and is the appropriate entity to ensure compliance with U.S. antitrust policies.

CONCLUSION

In conclusion, the Administration believes that modification of the AT&T Consent Decree to permit Bell company entry into manufacturing will have a significant, positive impact on the operation of the U.S. telecommunications industry. This important growth industry will be better positioned to thrive and to serve the American public, as the United States strives to maintain its competitive edge globally. It is time to resolve this controversy, which has lingered too long in the courts; and it is time for the elected branches of our government—the Congress and the Executive branch—to set the direction of telecommunications policy for this country.

Action allowing Bell company manufacture of telecommunications equipment subject to effective safeguards will provide certainty to industry participants; and in so doing, it will permit U.S. manufacturing companies—including the Bell companies—to concentrate on the contributions they can make to enhance efficiency, spur competition, and introduce innovations in these important global markets.

Senator INOUYE. Thank you very much, Madam Secretary. And may I now call on General Rill.

STATEMENT OF MR. JAMES RILL, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. RILL. Thank you very much Mr. Chairman and members of the subcommittee, I too, like my colleagues, have a prepared text that I ask permission to have inserted in the record.

Senator INOUYE. Without objection.

Mr. RILL. I appreciate the opportunity to appear before the subcommittee today to participate in presenting the views of the administration——

Senator INOUYE. Could you move your microphone up close, please?

Mr. RILL [continuing]. Certainly, Senator.—on S. 173. The administration strongly supports the objectives and basic thrust of this legislation. That is the removal of the line of business restriction contained in the AT&T consent decree that prohibits the Bell operating companies from designing, developing, or manufacturing telecommunications equipment.

Our prepared statement sets forth the background and judicial proceedings relating to the AT&T decree, so I will not presume on the subcommittee's time to describe them orally. We, the Department of Justice, do endorse removal of both the information services and manufacturing restrictions in the decree. The information services issue is now pending before the U.S. District Court for the District of Columbia. There are, however, no pending court proceedings to remove the overall manufacturing restrictions. Thus, the administration supports legislation to remove the manufacturing restrictions for the same reasons that we have sought judicial removal of these restrictions. They are no longer necessary to protect competition. Worse, these restrictions are themselves anticompetitive because they prohibit BOC entry into telecommunications equipment markets, and restrict BOC cooperation with independent suppliers in the design and development of telecommunication products for use by the BOC's and by others.

The telecommunications world of 1991 is very different from what it was in 1982 when the decree was entered. In 1982, a single entity, the Bell System, made the equipment purchasing decisions for the lion's share of all telecommunications equipment. Today, the 7 BOC's make individual decisions regarding their purchases of telecommunications equipment. Other purchasers in these markets, including private buyers and carriers not providing local exchange service, also buy very substantial quantities of this equipment. Thus, no single BOC's purchasing decisions are likely to have anticompetitive effects in the telecommunications equipment markets as a whole.

Further, there are many competitive suppliers of equipment to the BOC's and other carriers and users as well. A BOC that manufactures some types of equipment may well purchase some of its own products, but it is unlikely to supply all of its own equipment needs from internal sources. Partial vertical integration of this nature is common in many industries, and is generally procompetitive.

Moreover, certain types of equipment, such as network switches, require such a substantial investment and involve such significant economies of scale, that a BOC would need to sell outside its own

system, to outside purchasers, in order to operate most efficiently if it engaged in manufacturing. Thus, it would need to be skilled and efficient in producing these types of equipment for outside customers, and therefore, for inside use.

Further, as Chairman Sikes' statement indicates, the concern that a BOC might purchase inferior equipment or pay excessive prices to its manufacturing affiliate at ratepayer expense is alleviated by FCC regulations governing affiliate transactions, and by changes in the marketplace, particularly the divestiture, and the ability of regulators to make benchmark comparisons of BOC purchasing activities. Nor is there any significant risk that the BOC's would injure competition by denying independent manufacturers access to necessary information about local exchange networks. The FCC's rules provide for timely disclosure of network design information to provide that access.

Removal of the manufacturing restriction therefore in all probability will have significant procompetitive benefits. It is critical that the nation's telephone companies be able to take advantage of and participate in the rapid technological changes that affect this industry. Removal of the manufacturing restriction would permit the BOC's to design, or work more closely with independent manufacturers to design, equipment to best meet their own needs and those of other carriers and customers. This in turn would facilitate the efficient development and implementation of new services.

Removal of the manufacturing restriction would also permit elimination of the current waiver process that is in effect under the AT&T decree for such activities. That process currently delays, deters, or frustrates outright the provision by the BOC's of new products and imposes unnecessary burdens on the industry, the courts, the American public, and not incidentally the Department of Justice. In light of the potential for significant competitive benefits if the BOC's are permitted to enter telecommunications equipment and CPE markets and the absence of significant risk of anticompetitive abuses, the administration believes that the manufacturing restrictions should be eliminated as soon as possible.

In addition to lifting the manufacturing prohibition, S. 173 would impose certain new statutory restrictions on BOC manufacturing activities. While the administration endorses the bill's objective and principal thrust to guard against cross subsidization and anticompetitive discrimination, we are concerned that statutory provisions mandating structural separation and requiring comparable opportunities in BOC purchasing decisions may not be necessary to achieve this objective and could foreclose many of the procompetitive benefits the bill seeks to provide.

As FCC Chairman Sikes has discussed in more detail, the Federal Communications Commission has already developed and implemented information disclosure and cost-accounting rules that directly address the issues of discrimination and cross-subsidization, and it has the flexibility to modify those regulations if necessary to address any problems that could arise in the future.

In addition, the legislation would preclude joint manufacturing ventures between two or more BOC's manufacturing affiliates. The Department of Justice thinks this provision is unwarranted since the Antitrust Division will carefully scrutinize joint ventures in-

volving the BOC's to ensure compliance with the antitrust laws and will challenge any that are likely to injure competition. The prohibition on joint ventures between BOC's is also fundamentally inconsistent with the bill's objective of increasing competition in telecommunications equipment markets and with other congressional efforts proceeding simultaneously to reduce the antitrust risk that may unnecessarily deter legitimate and procompetitive research and production joint ventures.

Finally, as stated by Assistant Secretary Obuchowski, the administration opposes those provisions of S. 173 that would restrict the BOC's to manufacturing in the United States and require them to afford less favorable treatment to foreign component suppliers. These restrictions are, we submit, inconsistent with the bill's procompetitive goals in that they would limit the opportunity of the BOC's to engage in what could be efficiency-enhancing joint production ventures that might expand, not contract, U.S. markets.

These provisions of the bill could also undermine the U.S. competition-oriented trade policy in several respects. Ambassador Hills has stated that restrictions and preferences distort trade, discriminate against foreign goods, and create concern under our bilateral investment agreements and other international accords. Ambassador Hills has also indicated that such provisions would undermine U.S. efforts to obtain nondiscriminatory treatment of U.S. firms in the GATT negotiations and other international negotiations.

That concludes my prepared statement. I want to reaffirm the administration's support for the objectives and the basic thrust of the bill to lift the manufacturing restrictions currently imposed by the AT&T decree on the Bell operating companies. And I would certainly be pleased to answer any questions that the subcommittee may have. Thank you.

[The prepared statement of Mr. Rill follows:]

PREPARED STATEMENT OF MR. JAMES F. RILL

I am pleased to have the opportunity to appear before the Subcommittee today to present the views of the Administration on S. 173, "a bill to permit the Bell Telephone Companies to conduct research on, design, and manufacture telecommunications equipment." The Administration strongly supports the objective of this bill—the removal of the line-of-business restriction contained in the AT&T consent decree that prohibits the Bell Operating Companies ("BOCs") from designing, developing or manufacturing telecommunications equipment.

Legislation removing the equipment manufacturing line-of-business restriction would promote competition in an important area of our economy. This restriction no longer serves the competitive purpose for which it was imposed, and it excludes major U.S. telecommunication firms from participating in the development of products and services to serve present and future telecommunication needs. We are concerned, however, that some of the provisions of S. 173 may themselves be unduly restrictive and could interfere with the important policy objective of furthering consumer welfare by increasing competition in telecommunications equipment markets. I hope that our views will assist the Subcommittee in its deliberations on this important legislation.

BACKGROUND

You are probably familiar with the judicial proceedings that led to and have perpetuated the decree line-of-business restrictions, but it may be helpful for me to summarize them briefly. The consent decree was agreed to by the United States and AT&T and approved by the court in 1982 to settle a government antitrust case. In that case, the United States had alleged that AT&T illegally used its monopoly power in local exchange telephone service markets to injure competition in the telecommunications equipment and long-distance services markets. To remedy and pre-

vent recurrence of that anticompetitive conduct, the decree required AT&T to divest the BOCs with their monopolies on local telephone service. As a further prophylactic measure, the decree prohibited the divested BOCs from providing long distance services or information services, from manufacturing or providing telecommunications equipment, from manufacturing customer premises equipment ("GPE") and from providing any other product or service except exchange telephone services and directories. For convenience, I will refer to the restrictions on telecommunications equipment and GPE as the "manufacturing" or "equipment" restrictions.

In 1987, after conducting an extensive review of the decree restrictions, the Department of Justice concluded that in light of technical, market and regulatory developments since the 1982 entry of the decree, she restrictions on BOC participation in information services, manufacturing, and non-telecommunications businesses were unnecessary and unduly restrictive of competition and efficiency. Thus we asked the court to remove these restrictions as permitted under the decree. Judge Greene removed the restriction on non-telecommunications activities and modified the information services restriction to allow the BOCs to provide certain transmission-related "gateway" and storage and retrieval services. But he denied the United States motion for removal of the manufacturing restriction as well as the BOC's motions for removal of the manufacturing and long distance restrictions.

In April 1990, the United States Court of Appeals for the District of Columbia Circuit affirmed the district court's decision to retain the manufacturing and long distance restrictions. The Court of Appeals, however, remanded for further proceedings the question of removal of the information services restriction. The reason the Court of Appeals remanded was that AT&T had not opposed removal of the information services restriction. Since all parties to the decree consented to removal of that restriction, the Court concluded that the question of removal should be governed by a different and more lenient standard than the district court had used.

The information services motions have been briefed and are again before the district court. In that proceeding, the Department strongly supports removal of the information services restriction, and we are hopeful that the judicial proceeding will result in the elimination of that anticompetitive restriction. However, there are no pending court proceedings to remove the overall manufacturing restrictions, nor has AT&T altered its opposition to removal of those restrictions.

REMOVAL OF THE MANUFACTURING RESTRICTION

The Administration supports legislation to remove the manufacturing restrictions for the same reasons we have sought judicial removal of those restrictions. The manufacturing restrictions are no longer necessary to protect competition. Worse, these restrictions are themselves anticompetitive because they prohibit BOC entry into telecommunications equipment markets and restrict BOC collaboration with independent suppliers in the design and development of telecommunication products for use by the BOCs and others.

The telecommunications world of 1991 is very different from what it was in 1982, when the decree was entered. In 1982, a single entity made the equipment purchasing decisions for the lion's share of all telecommunications equipment. Today, the BOCs make individual decisions regarding their purchases of telecommunications equipment. Other purchasers in these markets, including private buyers and carriers not providing local exchange service, also buy substantial quantities of such equipment. Thus, no single BOC's purchasing decisions are likely to have anticompetitive effects in telecommunications equipment markets as a whole.

Further, there are many competitive suppliers of equipment to the BOCs and other carriers and users. A BOC that manufactures some types of equipment may well purchase its own products, but it is unlikely to supply all of its own equipment needs. Such partial vertical integration is common in many industries and is generally procompetitive. The concern that a BOC might purchase inferior equipment from or pay excessive prices to its manufacturing affiliate at ratepayer expense is alleviated by regulations governing affiliate transactions and by changes in the marketplace—particularly the divestiture and the ability of regulators to make benchmark comparisons of BOC purchasing activities. Under current regulation, federal and state regulators can scrutinize and disallow excessive equipment costs and, if necessary, could impose additional restrictions on BOC self-dealing. Moreover, as FCC Chairman Sikes will discuss, strengthened Federal Communications Commission rules governing cost accounting and allocation alleviate the concern that the BOCs will engage in anticompetitive cross-subsidization of unregulated activities with ratepayer revenues.

Nor is there any significant risk that the BOCs would injure competition by denying independent manufacturers access to necessary information about local ex-

change networks. The FCC's rules provide for timely disclosure of network design information, and current equipment manufacturers—especially AT&T and other manufacturers that provide and continue to update BOC central office switches—already play such a large role in BOC network design that they would likely become aware of plans for major changes.

Moreover, any BOC entrant would face vigorous competition in equipment markets. A number of the current manufacturers occupy strong positions in various equipment markets, deriving in part from substantial economies of scale and scope. Other equipment manufacturers are sizable firms that have strengthened their competitive positions in recent years through growth, consolidation and integration.

Removal of the manufacturing restriction in all probability will have significant procompetitive benefits. It is critical that the nation's telephone companies be able to take advantage of and participate in the rapid technological changes that affect this industry. It is well-recognized that the BOCs would be formidable competitors in the telecommunications equipment market, and they would be expected to apply their considerable expertise and efficiency in the development of innovative products to the benefit of American consumers. Removal of the manufacturing restriction would permit the BOCs to design or work more closely with independent manufacturers to design equipment to best meet their own needs and those of other carriers and customers. This in turn would facilitate the efficient development and implementation of new services especially exchange services to support the developing information service markets.

Removal of the manufacturing restriction also would permit elimination of the current waiver process under the AT&T decree for such activities. That process currently delays, deters or frustrates outright the provision by the BOCs of new products and imposes unnecessary burdens on the industry, the Department, the courts and the American public.

In light of the potential for significant competitive benefits if the BOCs are permitted to enter telecommunications equipment and CPE markets and the absence of significant risk of anticompetitive abuses, the Administration believes that the manufacturing restrictions should be eliminated as soon as possible.

PROPOSED LEGISLATIVE RESTRICTIONS ON BOC MANUFACTURING

In addition to lifting the manufacturing prohibition, S. 373 would impose new statutory restrictions on BOC manufacturing activities. It would provide that a BOC may engage in manufacturing only through an affiliate separate from the BOC's operating telephone company: it would require the FCC to prescribe regulations requiring that any Bell Telephone Company that has a manufacturing affiliate provide other equipment manufacturers "opportunities to sell such equipment to such Bell Telephone Company which are comparable to the opportunities which such company provides to its affiliates"; and it would require any manufacturing affiliate to make any telecommunications equipment that it manufactures available "without discrimination" to any other local telephone carrier that does not have a manufacturing affiliate or that agrees to make available to the Bell Telephone Company any equipment that it manufactures. S. 173 also would prohibit a BOC or its manufacturing affiliate from engaging in any manufacturing joint venture with another BOC or its manufacturing affiliate, and would require that all BOC manufacturing be conducted in the United States and, subject to certain exceptions, using only United States made component parts. We are seriously concerned with such statutory restrictions and conditions on BOC manufacturing.

The Administration endorses S. 173's objective to guard against cross subsidization and anticompetitive discrimination by the BOCs. We are concerned, however, that statutory provisions mandating structural separation requirements may not be necessary to achieve this objective and could foreclose many of the procompetitive benefits the bill seeks to provide. As FCC Chairman Sikes will discuss in more detail, the Federal Communications Commission has already developed and implemented information disclosure and cost accounting rules that directly address the issues of discrimination and cross-subsidization, and it could modify those regulations if necessary to address any future problems. We are also concerned with new FCC regulation of BOC purchasing decisions under a statutory "comparable opportunities" standard. Such regulation may be unnecessary to protect ratepayers or competition. As we have noted, purchases from affiliates are already regulated, and the BOCs have incentives to select appropriate products—whether from an affiliate or an independent manufacturer. The proposed statutory "comparable opportunities" requirement could invite complaints from disgruntled potential Suppliers that could consume enormous FCC resources and serve no real competitive purpose.

We are also concerned with the bill's provisions regarding the BOCs' sale of equipment to other local exchange carriers. BOC manufacturing affiliates usually will have incentives to make any equipment they manufacture available to as many customers as possible. Moreover, such equipment sales will take place in competitive markets comprised of non-BOC as well as BOC manufacturers; thus there does not appear to be good reason for governmental regulation.

We understand that there may be residual concerns about joint manufacturing activities involving several BOCs. As the Administration has emphasized in connection with research and production joint ventures, however, joint ventures often enable their participants to compete more effectively in global markets and provide significant benefits to consumers. The Department will carefully scrutinize joint ventures involving the BOCs and will challenge any that are likely to injure competition, but a blanket prohibition on such ventures is unwarranted. Such a prohibition is also fundamentally inconsistent with the bill's objective of increasing competition in telecommunications equipment markets and with other Congressional efforts to reduce antitrust risks that may deter legitimate and procompetitive research and production joint ventures.

Finally, the Administration opposes provisions of S. 173 that would restrict the BOCs to manufacturing in the United States and require them to afford less favorable treatment to foreign component suppliers. These restrictions, too, are inconsistent with the bill's procompetitive goals, and they could undermine the United States competition-oriented trade policy in several respects. As Ambassador Hills has stated, such restrictions and preferences distort trade, discriminate against foreign goods and create concern under our bilateral investment agreements and other international accords.. As Ambassador Hills also indicated, such provisions would undermine U.S. efforts to obtain nondiscriminatory treatment of U.S. firms in the GATT negotiations and other international negotiations.

To summarize, the Administration strongly supports removal of the unnecessary and anticompetitive restrictions on BOC manufacture and provision of telecommunications equipment and manufacture of CPE. Now and in the foreseeable future, regulatory, technical and market factors effectively constrain any risk to competition; thus, there is no reason to perpetuate an unusual prohibitory rule. Moreover, the manufacturing restriction is contrary to our goal of a competitive and productive future for these important global telecommunications markets. It imposes an anticompetitive brake on competition by seven major U.S. firms and thus impedes the efficient development of new and improved products and services. However, the additional conditions S. 173 would impose on BOC manufacturing raise serious concerns; they appear to be unnecessary and inconsistent with the bill's fundamental procompetitive objectives and with U.S. trade and competition policy.

This concludes my prepared statement. I would be happy to address any questions that the Members of the Subcommittee may have.

Senator INOUYE. May I begin the questioning? Chairman Sikes, recently three trade organizations circulated a compromise proposal relating to the matter at issue at this moment. Have you studied this proposal?

Mr. SIKES. I have not studied it. I have looked at it.

Senator INOUYE. Do you have any thoughts about it?

Mr. SIKES. Yes. I think that it is short of what the bill intends to encourage. I think its principal flaw is that it would block joint ventures. A company with new products would perhaps need increased capital and would approach a Bell operating company as a potential venture partner. That joint venture would be blocked, however, because that company would obviously intend to enter into the fabrication part of the business.

I think it is also very difficult to begin separating what you can do and what you cannot do. I do not think we want our scientists, engineers, and product managers to have to carry around a legal text to sort through what is or is not permissible.

Finally, I think is stands on a faulty premise. I do not think Bell operating companies can prefer customer premises equipment, terminal equipment, if you will, manufactured by an enterprise in which they have an interest because it is too competitive a market.

People will not buy overpriced or underperforming merchandise. It additionally has, under the price-cap form of regulation, an incentive to buy the most efficient and productive network equipment. Again, if it was favoring the fruits of its own enterprise, but those were less efficient or less productive products, then it would again be kind of shooting itself in the foot. So, I do not think that particular approach would be sound.

Senator INOUYE. Madam Secretary, do you have additional thoughts about this so-called compromise?

Ms. OBUCHOWSKI. We have looked at it and were certainly pleased to see that the companies involved have been looking at modifying the manufacturing restriction. But again, I would agree with Chairman Sikes that it does not go far enough. It basically keeps these companies out of manufacturing, which again continues a situation where you have research scientists doing a lot of line drawing. That would also inhibit investment. It would inhibit acquisition of companies that are in manufacturing which has been one of the problems that we have encountered.

Furthermore, as we read the compromise, it would only apply to R&D done for internal consumption. And if you look at the trade difficulties of the United States, one of the objectives we would have in letting the Bell companies get into manufacturing would be that they manufacture for export. And under this compromise as we interpret it, that is not permissible.

Senator INOUYE. Mr. Rill, do you have anything to add?

Mr. RILL. Mr. Chairman, I am completely in accord with Assistant Secretary Obuchowski's statement. In addition, I would add that there is a factor of complexity involved in attempting to delineate what would constitute manufacturing or fabrication contrasted with what would constitute design, a matter which has involved court participation to a greater extent than I think anyone, probably even the court, would like. So, I think there are complexities there too that would militate against the compromise.

Senator INOUYE. Mr. Chairman, ever since AT&T lost the monopoly over the equipment market, thousands of new manufactures have entered the market. And now, I gather that consumers benefit from cheaper and more innovative telephones and new services. And I think all of us will agree that our telephone system is the best in the world. Our trade deficit has gone down from $2.6 billion in 1988 to $800 million in 1990, according to Department of Commerce. If it is doing so well, why should we change it?

Mr. SIKES. Well, I think that it was good that AT&T was broken up. Maybe I am a minority in that respect. I think it did produce a number of new companies, that is the circumstances that followed the break up of AT&T. But we now have seven entities. This bill certainly would not allow those seven to come back together. We have a much changed market where it is truly an international market. It is no longer specifically a domestic market. And I think the disincentives for Bell operating companies to favor the fruits of their own manufacturing enterprises are strong enough now that there is just no potential for significant harm to the manufacturers that have developed. The Bell operating companies, on the other hand, offer a significant source of capital.

We have seen over the last 3 or 4 years a number of small and innovative companies purchased by foreign companies because they have reached a certain stage in their maturity, and they have needed significant capital to take their business into the next stage. If I had to pick out a single reason for believing this is a strongly needed piece of legislation, it would be that reason.

Senator INOUYE. Thank you very much. Senator Hollings.

The CHAIRMAN. Thank you, Mr. Chairman. I did not know the recycled amendment that is going around would be characterized as a compromise. The thrust of the bill is to allow the Bell companies to manufacture. And the so-called compromise is to absolutely prevent them from manufacture. So, let us talk about the sabotage, not the compromise. [Laughter.]

But that is not going to fly.

Now let me get Mr. Sikes to the meat of the coconut here with relation to the misgiving of the FCC on page 3, section 227(c)(2) where we say neither a Bell company, telephone company, or any of its nonmanufacturing affiliates who perform sales, advertising, installation, production, or maintenance operations for a manufacturing affiliate. And then in order to enforce that, over on page 9 in the section (e), it is 227(e), at the bottom of the page, line 17, the commission shall prescribe regulations to carry these things out. And again on the top of page 10, the commission prescribes those regulations—I am not quite clear in my mind where you think these provisions in the bills are that Mr. Rill says could foreclose benefits or that these are new requirements that you already are equipped to do and that could frustrate the intent of the bill. Elaborate on that and why.

I think these provisions are fundamental to the measure because you have got to understand where we are coming from. We are coming from an area where these companies formally did do just those things, use their common carrier provision to engage in Mr. Rill's antitrust activities. And then finally Mr. Rill caught them. And according from the Senator from South Dakota, they are still violating it. So, why not put it in the bill?

Mr. SIKES. Well, I think, first of all, that there are now rules that protect against cross subsidization. I would not disagree with parts of the language that you just reviewed. Probably the two areas where I feel we can work closely to make sure that the rules in this bill and our rules are harmonized—so we are not involved too much in a kind of belts-and-suspenders regulatory regime—would be in the area of protocol filings and also where there would be a complete separate subsidiary requirement.

I worry when you have kind of total firewall that you lose the potential for cooperative work between people who are on the operations side and people who are on the research and development side, and then on up through the manufacturing process.

The CHAIRMAN. But the firewall, of course is from the common carrier revenues.

Mr. SIKES. That is right.

The CHAIRMAN. And we do not want the telephone rates to go up to get them into further manufacture business.

Mr. SIKES. We absolutely need to keep that financial separation, and with that I completely agree. But there are going to be in-

stances where I think people working in various facets of a company's work benefit by working together.

The CHAIRMAN. Madam Secretary, you were talking, and I was trying to find it in your statement, to the effect that you said eliminating the lawyer on each research team. You referred to eliminating the lawyers on the research team. Does this bill provide that? I am doing better than what I thought. [Laughter.]

We can eliminate lawyers.

Ms. OBUCHOWSKI. As a member of the bar, maybe I should reconsider, but in the United States as the manufacturing restriction now works, there are such fine lines that need to be drawn that basically you do need researchers to be very closely involved with lawyers to ensure that they do not step afoul of the restriction. Our perspective is in an economy that is in desperate need of increased investment in R&D and as much innovation as possible, you really do not want your most creative minds hamstrung by a lawyer on each research team, which is the case at the moment.

The CHAIRMAN. I understand your misgiving relative to domestic content, but now 40 years later in this trade development, and the market is developing into a global competition among the various governments—I heard way back that 40-some years ago that a Senator which I was not then, of course, Hollings, I can compete with any company in Japan, but I cannot compete with the government. And that is the similar situation today. And it is more so today. So it is not us setting a nice example.

I was a member of the High Y and liked to set nice examples and all of that, but this is trade, this is market, this is money. And when you have got money involved, you have got to make it in their economic interest. And all of these others in the automobile industry, whether it is the United Kingdom in Europe or the other, they have got domestic content provisions. You are not opening any market by the debate or the argument in GATT. GATT will do a little bit on oranges or do something on cigarettes, and may get intellectual property, but that is about all. They cannot get anything fundamental that we have found.

So, rather than go overboard, I would rather in the real world make sure that we are not accelerating the outflow of manufacturing capability and technology. Now everyone is very proud of the outcome of the gulf war due to our superiority of technology. So superior that they were operating in the dark, we were operating in the light. We had infrared. We could see at night, we could see through the clouds. We could hear all the conversations. And veritably a world power against a Third World country, we can prevail with an air force.

I do not think a single tank, U.S. tank, was hit in this war. I am going to find out if I am correct, but my best information is a tank of the United States or any of the other tanks, British, French, or otherwise, Saudi, even got hit. And that is to the credit of the technology.

Now there we are. The technology is what we need in communications in order to be competitive and improve our trade in communications, get the patents, get the development. And if you do not have the incentive to manufacture, you are going to be losing out there. And if we can get the domestic content in there and make

sure that we do it here, then later on we can adjust. But that is the only way it is going to open up the market.

This argument I have heard from the White House and otherwise is it is going to ruin Ambassador Hills' position in GATT. With all respect for Ambassador Hills, we have been through more ambassadors in trade. And we keep going out of business. And invariably, as Pat Choate has testified before this committee, our trade representatives have gone and represented the other side. So, we live in the real world, and we have got to have a domestic manufacturing provision to make sure we follow the intent of enhancing U.S. manufacturing capability.

Senator Pressler, we have that letter of yours, and we have the gentleman from the Justice Department here today.

Mr. Rill, I understand, for example, that your Justice Department administered this particular proceeding that resulted in certain fines or penalties taken against U.S. West. And my distinguished colleague is interested in this matter, and I will let him take over. I think he is the next Senator maybe in line for questions. He asked for a detailed description of the four admitted violations and nine other allegations that were dropped. He asked for information on whether any of the admitted or alleged activities involved funds of personnel of regulated telephone companies and a listing of the disciplinary actions. Can you respond for us, please?

Mr. RILL. Yes. Let me give you a little background on the manner in which we go into a decree compliance investigation. Whether it is by our own initiation or by a complaint from a competitor or some ratepayer or injured party, we will conduct a preliminary investigation and then can proceed in any one of three ways.

We can issue civil investigative demands. We can exercise our rights under the visitorial provisions of the decree. Or we can ask that the matter be brought to the attention of a grand jury for investigative purposes. In this particular case, we investigated it in a variety of manners with a variety of aspects of the issues that were under our consideration.

For conduct to be susceptible to action under a decree, there has to be a clear prohibitory provision in the decree. The party has to have notice of it and the provision has to be violated. Now for a criminal prosecution to occur, there also has to be the additional element of willfulness. Criminal prosecution requires not only a demonstration of that kind of intent, but also establishes a higher standard in court—that is, the proof of intent and the other factors must be demonstrated beyond a reasonable doubt. Whereas, in a civil offense, as you know, we deal with a standard of only a preponderance of the evidence.

In this particular case, we reached a global settlement with U.S. West of the four violations and nine other matters that were under investigation. Our settlement resulted in a civil penalty which is the largest ever entered in the history of the antitrust laws, $10 million. And that penalty was accepted by Judge Harold Greene, who supervises the decree, a couple of weeks ago. In accepting the penalty, Judge Greene indicated that this was a strong remedy and, in fact, congratulated the Department in being able to obtain this relief.

I want to make clear that in our investigation, as we looked at all the factors available, it was our conclusion that we would not be able to prove the element of intent that would have warranted cur going forward and prosecuting any of the violations for criminal sanctions.

We have made information available to Senator Pressler and his staff. And we have other information that we will make available. There is a large volume of filings that we made in court that we can make available. And to the extent that we can, we will make all that information available.

As you can understand, we have to take a look at the statutory limitations under which we operate and the limitations in the decree with respect to confidentiality of information obtained under the visitorial provisions of the decree. But we certainly want to be as fully cooperative with the subcommittee as we can be.

With respect to the question of whether or not ratepayers—I gather the question was whether employees of organizations whose money is received from ratepayers were involved in any of the practices, either those practices found to be violations or other practices under investigation. I think the answer to that is probably yes. The operating companies that derive revenues from ratepayers are very broadly engaged in the activities of U.S. West, as for that matter are all operating companies.

Although I cannot cite particular names at this time or incidents, I am confident that employees of the specific operating companies that receive revenues from ratepayers were involved in the conduct that was under our review. Again, with respect to any information that we can make available, we certainly will.

The CHAIRMAN. I will let my distinguished colleague follow up at this time.

Thank you, Mr. Chairman.

Senator INOUYE. Thank you.

Senator Pressler.

Senator PRESSLER. Thank you, Mr. Chairman. I shall follow up somewhat on that, and I thank my colleague from South Carolina. I handed him a copy of my letter as we were walking over to vote and I thank him very much for joining me in that request.

I guess the reason for the letter is that there are certain things that the Justice Department or the FCC cannot give out but I think would be very useful, and my letter outlines that. For example, if indeed we have established that ratepayers did, that if some of the employees involved in U.S. West violations had their salaries paid by the ratepayers, I guess the question is, Should not the ratepayers be reimbursed for subsidizing illegal activity?

Now where do you stand on that?

Mr. RILL. Senator, we do not have authority in the Department of Justice to set rates. That is an authority that would exist either with the FCC for the origination or termination of interexchange communications, or with the States for local communications. We have the authority only to seek penalties that must be approved by the court for decree violations.

The provision in this particular $10 million civil penalty that is of relevance to your question is that none of that amount may be allocated by U.S. West to its rate base, and thereby penalize rate-

payers as a result of this violation. That is, they cannot raise the rates to cover the $10 million penalty. But so far as setting rates to reimburse ratepayers for the time of employees engaged in that kind of conduct, that kind of remedy is beyond our jurisdiction.

Senator PRESSLER. If you and Mr. Sikes could both look further into that. And also I look forward to a written answer from U.S. West to the points I have raised in my letter, which as you said, you cannot not.

Let me ask Mr. Sikes, what information can you make available to this committee regarding complaints filed at the FCC regarding any Bell Operating Company misconduct? I know you cannot state the name of the company under your rules, or that is the way I understand it. But what information can you make available to this committee regarding complaints?

Mr. SIKES. Are you speaking of complaints where we have taken action and the action has been finalized? Or are you speaking of this U.S. West situation?

Senator PRESSLER. The activity in general.

Mr. SIKES. Generally speaking, we proceed with a complaint investigation and do not provide information on it until we have decided whether to take action or not. As we take action, the bulk of that data is made available to the public. I have our general counsel here and there might be specific parts of the data that would not be made public. But I will assure you that we would work with you and make public anything that we are not legally prohibited from disclosing.

Senator PRESSLER. I see we have a vote underway, but State regulators tell me that they have concerns that, given the multi-State nature of the Bell company operations, they will have difficulty in enforcing this bill. Could you comment on this?

Mr. SIKES. We each—and I am speaking of the FCC on the interstate portion and the States on the intrastate portion—we each have cost-accounting methods. Many of the States in the U.S. West territory have price caps, which tends to temper, if not eliminate, the incentives to shift costs into the regulated rate base. So I think that we can, in fact, get into this and do it effectively.

Senator PRESSLER. How much additional funding would you estimate would be needed by the FCC and the States to fulfill the regulatory responsibilities of this bill?

Mr. SIKES. We are doing the things today that the bill calls for, with a couple of exceptions. And we have not provided CBO or OMB, for that matter, with cost estimates on the specific exceptions. For example, there are provisions regarding protocol filings, and other provisions. But again, we can provide cost data on that as well.

Senator PRESSLER. Mr. Rill, I understand you cannot comment on specific companies, but could you provide, for the record, an analysis of all MFJ violations you are currently investigating without mentioning specific companies?

Mr. RILL. I think we can accommodate that in general terms, Senator, to the extent that, as you indicate, we are not able to identify particular companies under investigation. I think the information would be somewhat generic but we will certainly see what we can get to you on it.

Senator PRESSLER. Good. And I do very much appreciate Chairman Hollings'—I talked to him on the way over—assistance in getting a written response, a thorough written response. I think the committee needs a thorough written response to the issues I have raised. And I know you cannot reveal all the things but I thank you very much.

Mr. RILL. We will certainly make available to you what we can, Senator Pressler, from the public record material.

Senator INOUYE. Thank you very much.

Senator Burns.

Senator BURNS. We do have a vote on and I think we ought to maybe lay the groundwork here so that we all know what we are talking about, the ramifications of this bill.

Mr. Rill, I understand one of the activities that got U.S. West in trouble involved a modification that they made in an IBM PC. U.S. West worked with some small domestic manufacturers in Hawaii and California to develop a circuit board that turned an IBM PC into an operator services computer.

They got in trouble because they made it telecommunications equipment. U.S. West, legally, could have made software that allowed the IBM PC to run pac man games or an accounting spreadsheet.

What U.S. West wanted to do would have allowed a small telephone company to buy a significantly cheaper operator services equipment that is available in the market. But U.S. West was stopped from bringing this idea and this product to the market.

If this bill becomes law as written today, would U.S. West have violated a manufacturer restriction?

Mr. RILL. My understanding is, Senator Burns, it would not if this bill were law at the time of the conduct. It is my understanding that the practice that you refer to would not have violated the restriction because there would not have been a restriction, and therefore, U.S. West would have been free to undertake the workstation modifications and conduct that was part of the decree investigation.

Senator BURNS. OK. Now let us take it one step further now. What experiences have you had with the independent telephone companies that are also—they are manufacturing their own equipment and also they are using their own equipment. For instance, once the Contel merger is complete, GTE will be larger than any Bell company providing about 18 million lines. Yet GTE can manufacture equipment and has not been able to disseminate or destroy their competitors—or decimate their competitors. They have not put anybody out of business, have they, to you knowledge?

Mr. RILL. Not to my knowledge, Senator Burns. And I think obviously one of the features of the bill that makes us comfortable is that it in no way removes our jurisdiction to challenge antitrust violations where they occur. And I feel comfortable with the FCC regulations, and also with the strong commitment of the Antitrust Division to go after violations that might occur in the context of any practice by any of the companies. But I am totally comfortable that the combination of FCC regulation and continued antitrust jurisdiction would prevent the sort of practice that you refer to.

And you are quite correct. We have not had any allegation of any predatory or any other anticompetitive conduct on the part of the firms that you are referring to.

Senator BURNS. Thank you, Mr. Chairman. I probably have a couple of other questions. I can get them answered by mail, though, if you do not mind. And being as we are in the last stages of this vote, maybe we should go do that.

Senator INOUYE. All right. Thank you very much. We will have to stand in recess for a few moments.

[A brief recess was taken.]

Senator INOUYE. Let us have a little order, please, because we have some important panels in addition to this important panel. And our colleague from Louisiana can proceed.

Senator BREAUX. Thank you, Mr. Chairman, and I thank the panel members. Let me ask Mr. Rill first. Let us take our thoughts back to about the time, 1982, when we were first talking about the break up and the orders and the agreements ordering divestiture. It is my recollection that very clearly the Department of Justice was a key player in advocating the divestiture and a key player in advocating the restrictions on the RBOC's following the break up.

One of those restrictions that the Justice Department, as I understand, strongly supported was the prohibition on any manufacturing by the RBOC's. Today your testimony is in support of manufacturing for the RBOC's. And I would like you to discuss why the Justice Department has apparently done a 180-degree turnabout and what their position is in light of the fact that the RBOC's are clearly still monopolies in their service areas?

Mr. RILL. Thank you very much, Senator. I would be pleased to discuss that issue. You are right in your premise that in 1982 the Justice Department strongly supported the line-of-business restriction on manufacturing. I think it is important to keep in mind, Senator, that the decree itself contains a provision for the review of those line-of-business restrictions both under section VIII(c) of the decree which was put in by Judge Greene, providing for the waiver process.

And also in Judge Greene's opinion, he made note of our commitment to undertake a triennial review of the restrictions and other aspects of how the decree was working. And that, therefore, built in the need to look at competitive conditions in the very fast developing telecommunications industry as it would be affected by the decree.

In 1987, that first triennial review was completed. Since the decree did not become fully effective until 1984, that was a 3-year review. The Department submitted a very comprehensive analysis that was done under the leadership of Dr. Peter Huber in the so-called Huber Report. And that report evaluated conditions then obtaining in the telecommunications industry. We have had the benefit of further developments since then, particularly developments with respect to the actual implementation of the cost accounting and affiliate transaction rules and other rules by the Federal Communications Commission.

So, rather than a 180-degree turn, I think our views have evolved with the conditions in the industry, as contemplated by the Department and as contemplated under the AT&T decree. And

what we see are the results that we had hoped for with the divestiture of the operating companies and the division of the operating companies into seven regional companies. And what we have seen there is that not any one company dominates the purchase market for equipment. And no one company at the most would purchase more than 15 percent of the equipment sold in the telecommunications industry in the United States. No one Bell operating company could manufacture all of its equipment.

As to some equipment, the major switching equipment, a single Bell would have to be able to sell it outside. It could not sustain the scale economy selling it only inside, so it would have to be very efficient in making that equipment to market it.

We have seen a very strong, competitive manufacturing industry develop. Of course, AT&T is the major player in that industry. And we see stronger regulatory provisions being put into place now, even different from 1987, being implemented by the FCC. You may remember that in 1982, the FCC, under different leadership, different rules, said that it had been unable to police cross-subsidization and discrimination by the integrated Bell System. Chairman Sikes has said today, as he has said before, that the FCC can police anticompetitive discrimination and cross-subsidization.

So, for all those reasons we think that the industry has evolved, and regulation has evolved so that the manufacturing restriction is no longer necessary to insure a competitive manufacturing industry, even if one assumes, which was our view in 1987, that the local monopolies of intraexchange communications remain.

I want to add what I said just before the vote, that at the Department of Justice we are making the commitment that we will continue to be vigilant, as I am sure the FCC will. We will be concerned with anticompetitive discrimination and we will pursue evidence of illegal cross subsidization under the antitrust laws. And we are confident that we will be able to play a strong role in preventing violations of the antitrust laws should this legislation pass.

I am afraid that is a very long answer to you question.

Senator BREAUX. Well, I thank you for the answer. I think it is very important to spell out what is different between 1982 and 1991 with regard to the perception of a changed position. And I appreciate the answer.

One other followup to Chairman Sikes. Turn your attention of page 9 of Chairman Hollings' bill if you have it. And it is a section dealing, down on line 17, where it says the Commission shall proscribe regulations requiring that any Bell telephone company which has an affiliate that engages in any manufacturing authorized by the bill shall do three things, essentially, they have listed. And I would like you to tell me what is you interpretation of what these requirements would mean?

No. 1, when it says that this affiliate shall provide for opportunities to sell such equipment to such Bell telephone companies which are comparable to the opportunities which they provide which such company provides its affiliate. What does that mean?

Mr. SIKES. Open procurement and essentially, I mean essential. I think that is a good, strong provision.

Senator BREAUX. That would mean that the Bell operating company would have to allow anyone to make an offer or a presenta-

tion to them for the right to sell their equipment to the Bell operating company?

Mr. SIKES. I think they are going to have to have procedures that are set up, which they could then point to, to assure other manufacturers an opportunity to sell the kinds of equipment to them that they are also making.

Senator BREAUX. What about subparagraph 2, that they should not subsidize their manufacturing affiliate? How do you write regulations to guarantee that that is done?

Mr. SIKES. We currently have, using cost accounting, joint cost manuals which are annually updated and put out for public comment. And it is those joint cost manuals that separate the costs, distribute the costs, and that are aimed at making sure that the costs of a competitive enterprise are not shifted into the rate base.

We then follow that up with staff audits, annual attestation audits, and we also have an automated reporting system so that we get data and are able to make benchmark comparisons. That is one of the points that General Rill made. That is, because there are now seven companies, you can make benchmark comparisons in how costs are distributed. What we call the ARMIS system, an automated reporting system, allows us to do that.

Senator BREAUX. What does subsection 3 mean to you when it says they shall only purchase equipment from its manufacturing affiliate at the open market price. What are we talking about with that section?

Mr. SIKES. That again would mean that they cannot overpay. And you know, we have affiliate transaction rules that go precisely to that point.

Senator BREAUX. Assuming a Bell operating company looked at a piece of equipment that was priced at maybe $5 a unit from their affiliate and $2.50 from another competitor. And they bought the unit from their own affiliate at the $5 price per unit. Does that raise flags? Would that be allowed? Is that going to be a violation or what does that mean?

Mr. SIKES. It raises flags. And assuming essentially technical comparability, they would be in violation of the law.

Senator BREAUX. Thank you, Mr. Chairman.

Senator INOUYE. Senator Exon.

Senator EXON. Mr. Chairman, thank you very much. I am sorry that I have been tied up on another committee and I am pleased to be back now, and I am very much interested in this whole process. And I thank you once again for calling it.

I assume that all of the panel are fully aware of the proposition that has been worked out by the New York Public Service Commission in an attempt to increase local competition by allowing some coaxial cable people to tie into the Bell Central operating facilities. Are you familiar with that proposition in New York? I assume that was approved by you people before it went into effect?

Mr. SIKES. No, it was not.

Senator EXON. Did that have to be or does it not have to be?

Mr. SIKES. No, it does not have to be.

Senator EXON. Are you familiar with the negotiations or how that—in other words, if it is an arrangement of the local Bell oper-

ating company with those who wanted to offer that particular service. Is that correct?

Mr. SIKES. Well, it first of all, dealt with intrastate services, so it was not under the jurisdiction of the FCC.

Senator EXON. But it would be if it went interstate?

Mr. SIKES. That is correct.

Senator EXON. Has that matter ever come up before any of your agencies for consideration?

Mr. SIKES. Yes. We have a docket pending currently.

Senator EXON. Is this the first one?

Mr. SIKES. I am not sure it is the first one, but since I have been chairman, it is the first one. Generally we refer to it as a metropolitan fiber systems petition. They are essentially a transport company providing fiber optic loops in large metropolitan areas. And they would like to get access to more business.

Senator EXON. Sure.

Mr. SIKES. And the access is essentially controlled by the local exchange carriers.

Senator EXON. And at least in this one case in New York City, the Bell operating companies accepted the arrangement with the installer of this system. Is that correct?

Mr. SIKES. I do not know all of the details of that. I presume the New York Public Service Commission was heavily involved in that and so it was not necessarily completely worked out by private parties. Maybe Ms. Obuchowski knows more about the specific arrangements.

Senator EXON. As I understand the next step in that particular proposition would not only be intrastate, but interstate. And if they went to that kind of a system, it would come before the Commission?

Mr. SIKES. That is correct.

Senator EXON. Has the Commission ever ruled on that particular matter as of today?

Mr. SIKES. No.

Senator EXON. It has not. Can you tell us anything about the likely decision time as to whether or not you are even going to consider it?

Mr. SIKES. We are going to consider it.

Senator EXON. The one that is presently before you.

Mr. SIKES. Yes, sir. We are considering it.

Senator EXON. Do you have any timeframe as to when the decision will come down?

Mr. SIKES. This year, 1991.

Senator EXON. Thank you, I have no further questions, Mr. Chairman.

Senator INOUYE. Senator Danforth.

Senator DANFORTH. I want to congratulate both the chairmen for holding this hearing and Senator Hollings for introducing this bill. I had a point made to me by a friend of mine yesterday that I must say caused me pause. He said this issue is airline deregulation all over again. I supported airline deregulation and I have supported this concept. But it does give me pause.

I want to just ask you, all three of you, I guess, if you could explain one thing to me. Back in 1987—Chairman Sikes, I think you

were then the Assistant Secretary for Communications and Information—at the Commerce Department. The NTIA's trade report in February 1987, said joint venturing between the Bell companies and foreign manufacturers would likely cause significant harm to American competitive technology and trade position and could pose the threat of destroying this country's indigenous central office equipment manufacturing capacity. A very strong statement. The threat of destroying this countries indigenous central office equipment manufacturing capacity. What was the rationale for that conclusion?

Mr. SIKES. I recall that language specifically. The International Trade Administration insisted that language be put in and it was their theory, at least, that a Bell operating company would joint venture with, say, a Siemens of Germany, or an Alcatel of France, or an NEC of Japan. And, that would then assure a market here for the fruits of that joint venture. They were worried that it would therefore be harmful to, say, an AT&T or a Northern Telecom, which while Canadian has a very major set of assets in this country.

I think the risk of that happening has attenuated significantly. I think the provisions in this law relating to open procurement, and the incentive regulation adopted by the FCC, and in many of the States, is in part an additional safeguard against that prospect.

Senator DANFORTH. Do you agree with that?

Ms. OBUCHOWSKI. I think Chairman Sikes sums up the present point of view. We see a very globalized market at present. That has been an evolution throughout this decade. We see U.S. companies participating in joint ventures overseas and the converse also being the case.

Senator DANFORTH. Let me just ask you a question. Let us say Siemens and a Bell company entered into a joint venture. Where would the Bell company buy its own equipment?

Ms. OBUCHOWSKI. I suppose it would depend on what the equipment was.

Senator DANFORTH. If they were manufacturing—the joint venture was manufacturing the equipment.

Ms. OBUCHOWSKI. Well, they would have to follow under this bill an open procurement.

Senator DANFORTH. Pardon?

Ms. OBUCHOWSKI [continuing]. Under the bill, if they were manufacturing equipment, they would have to follow an open procurement regime. And I assume if they were manufacturing this equipment and it was the best at the best price, they would procure from themselves. If there was a better company out there with a better deal, under this bill, they would have to buy it elsewhere.

Senator DANFORTH. Better than their own deal?

Ms. OBUCHOWSKI. That is the way the bill is structured.

Senator DANFORTH. Mr. Rill, the Justice Department also took a very strong position back in 1987 and said, joint ventures between the Bell operating companies and foreign manufacturers would be a national disaster of major proportions. Do you think that that national—well, first of all, is that still the position of the Justice Department, or is that old hat?

Mr. RILL. That is not the—that abstract statement is not the position of the administration or of the Department of Justice.

Senator DANFORTH. It was in 1987.

Mr. RILL. I am aware of that, Senator Danforth. I think that what we have now is an ability and an incentive and a propensity to look at joint ventures as well as mergers and acquisitions on a case by case basis and to take action to prevent those joint ventures as well as mergers and acquisitions that would have an adverse affect on competition in the United States.

Senator DANFORTH. Do you think, Mr. Rill, that say a Southwestern Bell had a joint venture with Siemens to produce certain equipment, and Southwestern Bell was in the business of purchasing the equipment and the Germans were in the position of purchasing that equipment, they would have a competitive advantage dealing with their own companies? Generally, what would be the position of the antitrust division? That that is fine?

Mr. RILL. They would certainly—no, I do not think we could answer whether that was fine or malignant just from the broad statement. We would have to know the terms of the venture, what the equipment involved would be, what the potential market shares were of the joint venture.

Senator DANFORTH. Are there competitive advantages inherent in doing business with yourself?

Mr. RILL. There may be efficiency advantages inherent in doing business with yourself. To the extent that there is not a market power concern, and there may be or may not be, depending on the facts of a particular situation, we should be encouraging—we should certainly not be standing in the way of vertical integration that promises to produce efficiencies.

I think that one has to take a look at both the market power issue, which would include an analysis of who else is making the product, and what is the prospect of entry, as well as a sophisticated look at efficiency.

Senator DANFORTH. If you are really talking about a product where there are a lot of competitors and it is pretty well divided up, the market is pretty well divided up, it is one thing. But here we have a situation where there are these very large companies and with tremendous economic resources. And you are saying back in 1987, that joint ventures with foreign manufacturers would be a national disaster of major proportions, has that national disaster been fixed in this bill, or does the Justice Department have a different view than it had back in 1987?

Mr. RILL. I think the view of the Justice Department today is that we are capable of preventing joint production ventures which have the prospect of creating or enhancing market power.

And to the extent that joint venture occurs that creates or enhances market power, we will go after it, and we will challenge it, and we will try and prevent it from taking place. Whether we characterize it as a national disaster or an anticompetitive transaction, from our standpoint, is not of so much consequence.

In a market where there are big companies, there may also be a number of big companies that are competing. And we are dealing here with an abstract question. One would have to say that the situation may differ from, for example, CPE to switching companies.

Senator DANFORTH. Could you tell me, I mean, I do not know. You know antitrust.

Mr. RILL. So do you, Senator.

Senator DANFORTH. I honestly do not. The only thing that I know about antitrust is that Judge Bork was my antitrust teacher.

Mr. RILL. We share that. Not formally, but certainly he is one whose writings I have a great deal of respect for.

Senator DANFORTH. That was 30 years or so and I do not know anything about it. Can you tell me what has happened since 1987 that has transformed a pending national disaster to something that the Justice Department supports to the point of showing up and testifying?

Mr. RILL. Senator Danforth, I can only say, because I was not in the Government in 1987, I can say that today we have a strong, I think sound, I hope rational merger and joint venture enforcement program. In the last year, we brought more challenges to mergers and acquisitions, I am told, than in any year since 1973. I do not want to play a numbers game. So, I have some confidence that we will have an ability to prevent national disasters in the form of anticompetitive joint ventures in the telecommunications industry.

Senator DANFORTH. The antitrust division under the Bush administration is more efficient than under the Reagan administration.

Mr. RILL. Senator, I am not going to give a report card to me or to the Reagan administration. I just think that we have a sound enforcement program and we owe a great debt to the clarity and force of the merger guidelines that were developed in the Reagan administration.

Senator DANFORTH. Chairman Sikes why don't you answer and then I am going to drop it. It just seems to me that what we really are talking about is competitiveness and that really dire things were said back in 1987 by NTIA, by the Justice Department, and by the Labor Department, which said that 18,000 to 27,000 jobs or more would be loss if the manufacturing restriction were lifted. And that something has happened, either in the way the bill has been drafted or the way the antitrust division is set up or something in the meantime. And I just wanted to clarify that, I mean, as far as all of you are concerned, I take it that the positions that were taken in 1987 just do not hold true now.

Mr. SIKES. I would like to comment. First of all, I suspect that was an overstated objection in 1987, but we now have affiliate transaction rules. Those were used most recently in the NYNEX case where the operating company overpaid for merchandise from other of its affiliates.

We also have the benchmark data system where we can specifically look at what is being paid for lines, for circuit switching equipment, and so forth. And I think that is a significantly improved situation for policing the kind of conduct that might occur, if say, Southwestern Bell and Siemens were in a joint venture.

Ms. OBUCHOWSKI. Just two quick points on that report. While that statement was in the report, having reviewed the entire report, its general thrust is supportive of manufacturing entry, at least in the R&D area, and very strongly supportive. So, even back

in 1987, the thrust of that report was other than just that point on joint ventures.

The other point is that as an administration, we are always dealing a little bit with the unknown, whether this is going to happen or whether it is not going to happen. But we have become increasingly concerned with the manufacturing base of this country. When 50 percent of the industry cannot be participating and foreign companies are buying into our companies and forming such joint ventures with our companies, you have to ask yourself, is there a less restrictive alternative. We are confident that both the FCC under Chairman Sikes and the Antitrust Division under Assistant Attorney General Rill, can do the enforcement job concerned here.

Mr. RILL. Senator Danforth, I hope I am not communicating to you or the panel any kind of attitude toward joint ventures that is one other than vigilance with respect to mergers and joint ventures that have the prospect for creating or enhancing market power.

We will do our very best to seek them out and to prevent them. And I think that with the additional information available from the FCC's improved regulations, we will be able to do an effective job in that regard.

Senator DANFORTH. All I am saying is this. I do not really know the answer to it. All I am saying is that Senator Hollings in his bill, has raised the question of international trade. I generally oppose domestic content requirements. And as a matter of philosophy, have done so many times in the past.

But it seems to me that we are entering into a very serious situation which was predicted in 1987 to be dire in the words of the previous administration. If you are now going to change your position on joint ventures or say that something has happened in the meantime to obviate the situation, and at the same time testify against Senator Hollings, that, to me, says that you have solved, in your own minds, an issue which was very serious in a different form in 1987. And is very serious as far as Senator Hollings is concerned.

Senator INOUYE. Senator Kerry.

Senator KERRY. Thank you, Mr. Chairman. Senator Danforth has asked some questions along the lines that I also wanted to pursue. But I would like to ask, first of all, for a long time Congress has been admonished not to pick winners and losers and there has been a philosophy that says, we do not pick winners and losers. Let the marketplace do it.

In effect, what you are asking to do, it seems to me, is pick a current winner, give them potential to be a bigger winner, and perhaps create some losers. Can you tell me why we are not, in fact, doing that, specifically?

I mean, if you take—we have got 7 of the top 35 corporations in America, each of which it is acknowledged, still has the same bottleneck tendencies that promoted the initial decree. And you are suggesting that we ought to allow them to go into joint ventures with Siemens, Alcatel, NEC, whomsoever, have the ability to sell, as you say in a sort of competitive structure that we are going to create, which I want to ask you some questions about, when 6,000 or so manufacturing companies have come on line in the last years. And as Senator Inouye said, the trade deficit appears to have come down.

If you take the low end of that deficit out, faxes, and answering machines, and so forth, in effect we are at a surplus. So, why would we not simply be taking some of those 6,000 companies and saying, "Sorry folks." These bottleneck companies are now going to have the ability to be bigger, that they are going to compete. Say goodbye.

Mr. SIKES. Are you directing that to me?

Senator KERRY. I am directing it first to you and then Ms. Obuchowski.

Mr. SIKES. First of all, I would challenge the number 6,000. You know, I reviewed before I came in, the TIA membership, which is, I think, Telecommunications Industry of America. And it fell dramatically short of that, and many of the companies were American subs of foreign companies.

Second, I think you will hear later in this hearing from a number of small U.S. companies which would like to have the option to do joint ventures with Bell operating companies because they have reached a stage in their companies' development where they need capital to take the next step. So, I think that would enable those companies. I think there would be a significant new source of venture capital.

And I think the thing we can say for sure is that without some relief from the AT&T consent decree restrictions, what we have done is we have put an absolute freeze on ideas, and on capital, and on ingenuity coming out of the Bell operating companies. I just do not think that is sound communications, or competitiveness, or manufacturing policy.

Ms. OBUCHOWSKI. To amplify on the winners and losers point, we are by no means here choosing winners and losers. What we are trying to do, I believe, is apply an American precept. Let everybody in and compete. We have no way to determine whether these companies will be successful or not. But what we do know is that in this country we have a deficit in R&D and we have a trade deficit.

Given that setting, in spite of the improvement, we still have a trade deficit. From our vantage point, it is time to consider unleashing these companies into this field.

Senator KERRY. When you say we still have a trade deficit, not if you take out, as I said, those low-end items. If you take out the faxes, answering machines, telephones, you do not have a deficit. You have a surplus of $1.6 billion.

Ms. OBUCHOWSKI. As you know, this is one of our sunrise industries. This is one of the two or three industries that in this country we are the most proud of, that we know we are extremely strong in. So, the fact that we are sitting here saying to ourselves, the trade deficit has diminished but still remains, is just not good enough. And the fact that we are saying that fax machines are part of it, is also from our vantage point, not good enough.

Senator KERRY. The trend line is in the direction you want to see it in and it is really minimal at this point. The companies are emerging already. I mean, this is where the manufacturing side has made its advances, has it not?

Ms. OBUCHOWSKI. Sure. We want to see, and certainly Secretary Mosbacher is working very hard to see that trend line completely turn around. We think that with appropriate safeguards, those

6,000 companies or however you want to count them, can remain very aggressive in this market and in overseas markets.

But the real question is, whether you have about roughly $100 billion in cash, constantly steered away from R&D, how you see these cash rich companies investing only 1.3 or 1.4 percent in R&D in an industry where companies like NEC, Fujitsu, Alcatel, all companies that have been mentioned today, are investing 10 percent on average. So, that is the problem we are trying to address.

Senator KERRY. In the nondefense sector in communications in 1989, R&D rose by 8.3 percent and in 1990 it rose by 11-point-something percent. I think you are not accurate there. There has been an increase in R&D.

Ms. OBUCHOWSKI. There has been an increase but in terms of the Bell companies——

Senator KERRY. You said there was a growing deficit.

Ms. OBUCHOWSKI. There is a growing deficit in relation to where other countries are operating. You have basically——

Senator KERRY. Those percentages are ahead of the 10 percent you gave us that other countries are spending.

Ms. OBUCHOWSKI. I do not believe in general that is the case. In general, when you look at the studies, even submitted by opponents of this bill, overall investment in R&D has remained flat.

Mr. SIKES. I think, also, if I might just add one thing. GTE is now the Nation's largest local exchange carrier. It has been for decades involved in manufacturing, and to my knowledge there has not been egregious or significant harm to public interest. What we are talking about is a bill that would let companies that are, in fact, smaller than GTE, do the same thing GTE has been doing for a long time.

Senator KERRY. In the bill, what concerns me a little bit is you talked about the regulations that will be established to guaranty opportunity for companies to sell the same products to a company as it is manufacturing or joint venturing. And the paragraph in the bill says that you are going to have to issue a regulation so that they provide to other telecommunications equipment manufacturers, opportunities to sell such equipment to itself or any of its affiliates which are comparable to the opportunities which it provides to itself or any of its affiliates.

Now, I take it that is the regulation you are referring to that is going to keep this open door. Is that accurate?

Mr. SIKES. I think the open door is going to be largely sustained by market forces. IBM went out of the computer store business because it could not make it selling its own equipment. You just cannot use, regardless of how powerful you are, your own equipment in computer and communications markets these days, at least not exclusively. So, I think market forces are going to largely keep it open. But I think this regulation will help as well.

Senator KERRY. But what they tell me, what a lot of the Bells tell me as they describe the need for this, is that there is a restraint now. They cannot do the design and sort of development work necessary. And there are such strict limits on research under Judge Greene's order that they have great difficulty satisfying their needs.

So, if we do this, they are then going to be able to design systems according to their needs, which are so specific it seems to me, according to those needs, that you could in fact, by virtue of that very specific design requirement, exclude anybody else from being able to provide a similar product. And in effect, create an exclusionary process rather than a competitive process.

And I would assume, because they want to be able to buy from themselves and sell to themselves, because that is the way you make money, that the compulsion will be to have a design requirement that is not like anybody else so there is no one else in the market to be able to provide it to. So, how are you going to police that?

I mean, you say you are going to police that. How will you police that?

Mr. SIKES. First of all, market forces are going to constrain that kind of——

Senator KERRY. They are going to create the market for us.

Mr. SIKES. No. 1, they depend on interoperability. They absolutely are dependent. It is their plasma. Second, they cannot make things just for themselves and make any money. They have got to sell into the whole market, and they have got to sell into the international market. They cannot simply create their own market and make a profit.

Senator KERRY. But if they are joint venturing, they have the ability. I mean, this is what we went through a little bit with Beta and VHS and so forth. It seems to me, maybe I am wrong, but I can see the same kind of dynamic taking hold here.

Mr. SIKES. Also, the Senator's bill, I think some of its provisions are unnecessary because I think our rules, sustaining the fundamental value of interoperability, are sufficient. But Senator Hollings' bill has a provision that specifically calls for filing protocols with the FCC and disgorging relevant network information.

Senator KERRY. Now when it says that you are going to try to prohibit them from subsidizing the fully separated subsidiary with revenues from the regulated telecommunication services, you are viewing cross subsidy in that definition purely as capital that accrues by virtue of the direct revenue from the exchange service itself; correct?

In other words, it is just the cashflow. But what about the ability that they get to leverage capital by virtue of their overall asset base that is, in effect, a reflection of the rate regulated status that they have? Is that not, in effect, a cross subsidy?

Ms. OBUCHOWSKI. I guess if the point is their cost of capital, that they, by virtue of being very stable companies, could have a lower cost of capital. We are competing in a global marketplace for equipment and NEC, Fujitsu, Alcatel, Siemens have some of the lowest cost of capital in the world. And that is precisely why they are able to compete.

So, I think any company that has a low cost of capital in the United States, particularly where we are worried about high cost of capital, I mean, assuming no cross-subsidization, should be encouraged. Certainly IBM and ITT have low cost of capital because they are highly diversified and we say, great, go at it.

Senator KERRY. I understand that but it seems to me that if you are—I understand you are limited only to sort of direct revenues. But on the other hand, their entire status, their entire power in the marketplace, comes from a rate regulated, bottleneck status. And it seems to me that that is inherently an advantage in reducing their cost to capital against any other competitor in the marketplace. And the moment you permit them the joint venturing that they will gain here, it seems to me, again, in this winner/loser equation, that you are greatly disadvantaging, we are, by Government edict, greatly disadvantaging people where I am not sure, and I say I am not sure and I need to work this out more, but I am not sure that the imperatives for the original order have disappeared.

Ms. OBUCHOWSKI. Senator, I think your concerns about bottlenecks are valid ones. And putting into place interconnection requirements, cost allocation requirements, all those kinds of safeguards by the FCC address them. But on the cost of capital point, I really think we would be looking for winners and losers if we were looking at each different company in the economy and saying, well how come they have lower or higher cost of capital. Maybe we should keep them out of businesses because their cost of capital is low.

And indeed, we are in an economy where, for example, NEC, Northern Telecom, Siemens, all have very, relatively speaking, lower costs of capital because they have protected markets to an extent. And they are full and open to compete here in the United States.

So, by that measure, we cannot say, "Because a company is getting a lower cost of capital for whatever reason, we do not want them in manufacturing." We sure do not want them cross-subsidizing. But I think a lower cost of capital, a stable capital source, is really all to the good.

Mr. SIKES. One of the problems, Senator, is that State regulators or the Federal Communications Commission would not allow the companies to earn a rate of return if they put all the capital they earned back into their regulated rate base. So, they have got to put their capital elsewhere. And the question is, Do we want them to put it in the insurance field, for the real estate field, or the telecommunications field?

Ms. OBUCHOWSKI. And I think this administration, for one, is pretty concerned that, for example, the cable consumers of the United Kingdom and France are the beneficiaries of the low cost of capital that the Bells now have, as opposed to our manufacturing base.

Senator KERRY. Would you support a safeguard that would bar Bell joint ventures with those foreign firms whose home markets are closed to our firms? I mean, if that is part of our goal here.

Mr. SIKES. Again, I would defer to the administration on the trade policy dimension of that.

Senator KERRY. Let us go vote.

Senator INOUYE. We have another vote. I hope the witnesses will remain here. Senator Pressler has a few more questions to ask, and Senator Hollings.

The CHAIRMAN. I think this panel has been unusually good. And Madam Secretary, you are outstanding. I am going to have to learn to pronounce Obuchowski.

Ms. OBUCHOWSKI. You got it right the first time.

[A brief recess was taken.]

Senator INOUYE. The committee is most grateful to this panel for the patience that they have demonstrated all afternoon. I believe this will be the last question.

Senator Pressler.

Senator PRESSLER. Mr. Chairman, I might just say that I walked back over with Chairman Hollings—we have two chairmen—but I suggested to him, and he seemed to concur, that we do need on this U.S. West matter, to dig into that a little bit, to get the facts in terms of the additional information. As I understand it the Justice Department and the FCC can only give what is in the settlement. But there were nine things that were dropped.

We have learned that rate employees were utilized in some of the illegal activities, how the company transfers that money. None of the fine, the $10 million fine, is supposed to be allocated toward ratepaying people. It is somehow supposed to come from other sources, as I understand it. How the company is going to allocate that.

I think since the amount of publicity that that huge fine got—and it was the largest one in history—that before making a fundamental change in the way the BOC's operate, it would behoove us as a committee to have in writing answers to some of the questions. Chairman Hollings is going to try to get those, but also I would suggest for your consideration, Mr. Chairman, the possibility of having U.S. West here, the president, to have a hearing or part of a hearing on this subject, to find out what exactly led to that large fine, what steps have been taken to correct it and so forth.

I just wanted to ask the final questions. I have stated it correctly: the Justice Department can only state what has been in the papers, which has been just the tip of the iceberg. But the company could voluntarily discuss this.

Mr. RILL. I think the company, certainly the company is not subject to the same limitations we are with respect to the company's own information. As I indicated, when we proceed either by civil investigative demand, or by grand jury process, or by the visitorial provisions of the AT&T decree, we are subject to confidentiality restrictions, as contained in the CID statute, the grand jury rules and the court decree.

As I indicated, though, Senator, we will give you everything we can, subject to those limitations, and look forward to cooperating with you.

Senator PRESSLER. I commend the Justice Department. It did everything possible to try to prevent ratepayers from being penalized for their company's actions. But as a practical matter, all the money is fungible, and there is no way to guaranty ratepayer funds will be isolated. And I want to emphasize that none of my questions I originally raised with U.S. West have been answered by U.S. West.

That is why I am trying to get to the bottom of this. I think it is important to the committee and important to this piece of legislation.

Senator INOUYE. Thank you very much, and I thank all of you very much. Our second panel this afternoon consists of the chairman and chief executive officer of Pacific Telesis Group, Mr. Sam Ginn, the senior vice president of American Telephone and Telegraph, Mr. Jim G. Kilpatric.

I would like to advise one and all that I intend to chair this hearing until we have heard from all the witnesses. So, all those who have been scheduled to testify, you may have to miss your dinner tonight. Mr. Ginn, welcome, sir.

STATEMENT OF SAM GINN, CHAIRMAN AND CEO, PACIFIC TELESIS GROUP

Mr. GINN. Thank you Mr. Chairman and committee members. Thank you for the opportunity to be here. The committee is to be congratulated for stepping up to this very, very complex issue.

I would like to say that action taken along the lines contained in the proposed legislation, I believe will have profound and positive effects on our industry, and also, by the way, the American consumer.

Mr. Chairman, a couple of administrative items. Today I speak for all seven regional companies. This may be the first time in history that we have all been together in such harmony. And I suspect it does not have much to do with the talents of the presenter, nor the quality of the testimony, but the urgency and the importance of the issue that we discuss today. Letters from the other six CEO's are on file with the committee.

Also supporting the legislation are institutions such as the Communication Workers of America, the National Council of Senior Citizens, the Association of the Deaf, the National Association of the Development of Organizations. And as you will hear later, many small manufacturers across the United States are going to tell you that they see this legislation as entirely beneficial for them.

So far you have heard from the policymakers at the Department of Justice, the FCC and NTIA. I think it is important to note that all have supported the thrust of the legislation. They have, I believe, stepped up to a number of concerns of the committee. It should be reassuring to you that those charged with the enforcement of regulations applied to the freed BOC's believe they can carry out their responsibilities in regard to self-dealing and cross-subsidy in and the public interest.

Now to my testimony, and what I would like to do here in the interests of time is simply give you an overview of my written testimony. I essentially made four points.

No. 1, the manufacturing restriction weakens American competitive capability in a very, very strategic industry. Second, it aggravates the trade deficit. No. 3, it impacts the evolution of the infrastructure of the telecommunications system in this country, and that is terribly important, because that infrastructure is going to feed out ability to compete globally in the next century.

And last, the current restriction stifles innovation. Now I will spend some time on this fourth point, because as a manager attempting to stimulate a company which is faced with changing technology, globalization of markets, regulatory restructure, and the MFJ, I can tell you that you need all the creativity and innovation from your people that you can possibly get. And I hope to convince that the current MFJ prohibitions hinder our ability to be creative and to innovate.

Let me take the first point, weakened American competitiveness. And maybe it is more than a coincidence that some of the manufacturing restrictions, some of the best players are not in the game. Our competitive advantage in the world market is eroding. We have come to understand how markets get weakened. We have seen it in autos, and we have seen it in steel, and we have seen it in consumer electronics.

And with that understanding, why would we continue to have 60 percent of the assets of the telecommunications industry on the sidelines—companies, incidentally, that know probably more about customer wants and needs than any other telecommunications companies in the country. They are out there every day, serving customers one at a time.

Now, maybe we see a familiar pattern. Is erosion taking place at the low end of the market? And what do we expect next? Would we expect to see the same pattern as we have seen in automobiles and consumer electronics? We need to contemplate that question. Can we expect to see the same erosion in telecommunications industry? Will the erosion go upscale?

Well, my second point was the manufacturing restriction aggravates foreign trade deficits. Whatever face you put on it, we have moved from a surplus prior to divestiture, to a deficit today. The world's leader should never find itself in a deficit position.

The third point that I made in my testimony is that telecommunications is the core of the Nation's infrastructure, and the foundation for providing American business the basis to compete in the global economy. Now this is terribly important. What we are talking about here is our ability to be a global competitor.

I cover in my written testimony what is happening in Japan, and it is awesome. Currently we enter this battle with the BOC's not being full participants. What we need to do is allow the Bell operating companies to participate in the innovation cycle.

This is an important concept. The innovation concept is the continuous process of identifying customer needs, and through research, design, development, and production—translating those needs into products and services. And it is clear to me that the biggest price we all have to pay in the RBOC's not being able to play, is that we cannot take full advantage of the innovation cycle.

Now let me further illustrate why this occurs. Now we talk about manufacturing, and it is a very complicated issue. Most of us think of manufacturing as fabrication or assembly. But that is not true in the case of the MFJ. For example, production of software code for switching systems is considered manufacturing.

Let me repeat that. Production of software code for switching systems is considered manufacturing. That means that we cannot upgrade the gut of our day-to-day phone business at will. Even if

we see a unique need in California, we cannot touch it. We have to go back to the manufacturers, and we have to operate off of their priorities. And incidentally, their priorities are not, maybe, always the same as ours.

Let me go to another part of our business, an example that perhaps is easier to understand. For example, we believe that pay phones of the future should have the capability to be interactive with a customer—allow the customer access to data base information, have that information printed out on site—a true public information terminal. Now remember, we have the detailed knowledge about coin phone reliability, their operation, their maintenance problems, customer usage patterns and future application needed to meet customer needs.

But because of the MFJ restrictions, we cannot design this product, we cannot participate with others in setting detailed specifications, we cannot provide equity funding to a smart entrepreneurial group going, and we cannot, of course, own our own facility to fabricate the devices ourselves.

In truth the innovation cycle that I referred to earlier has been blocked.

Now let us take the whole issue of compliance. And I want you to know on compliance, we take our responsibilities seriously. We have drilled into our employees that they not only must follow the law, but they must follow the spirit of the law. And we have detailed instructions that everyone must read.

But I would like to read to you the instructions that I just happened to read on the plane preparing myself for this testimony, that a Pacific Telesis employee must understand in order to comply with the manufacturing restriction of the MFJ.

> Pacific Telesis may not develop firmware or software integral to the functioning of hardware for customer premise equipment, central office switchers, transmission systems or other telecommunications equipment. For example, software generics for stored program control central office switchers containing algorithms which make the hardware work, are considered integral to the operation of the hardware. A rule of thumb: software that is not sold separately from the hardware is probably software integral to the hardware. Warning: software that is sold separately, e.g. certain switch generic software, may be integral to the operation of the hardware.

Now, I was attempting to find the attorney that wrote that, but then I began thinking about what was confronting that attorney, and I decided could not improve on it myself.

So, I have to ask you, if you are an employee of our company, and you are faced with that instruction, how innovative would you be? My own view is that we cannot keep the Pacific Telesis Group and the six other American corporations on the sidelines. What this bill can do is help us translate these customer needs into new products and services that allow us to unleash the creative potential of these companies, and thereby enabling our employees and the six other RBOC employees—close to 500,000 people—to work more effectively and efficiently.

American standing in telecommunications is at risk. I think Senator Hollings has answered the question properly. This bill will help save telecommunications from the fate of automobiles and consumer electronics.

Thank you, sir.

[The prepared statement of Mr. Ginn follows:]

PREPARED STATEMENT OF MR. SAM GINN

Thank you for the opportunity to appear before the Subcommittee today to discuss legislation which is significant to my corporation, to our industry, and to the American economy as a whole.

I would like to make four key points today. First, the restrictions of the MFJ, or Modification of Final Judgment, weaken American competitiveness in a strategic industry: telecommunications. As a nation, we must ensure that telecommunications does not experience the same fate that earlier befell our automobile, steel, and consumer electronics industries.

Second, the restrictions aggravate the foreign trade deficit. You will doubtless hear in this debate that the situation is improving. But the fact is, there remains a massive trade deficit in telecommunications—compared to a surplus prior to divestiture. How much more could it improve if seven of our best telecommunications companies were allowed to get off the bench?

Third, the MFJ stifles innovation. The restrictions prevent seven major American corporations from participating in what I call the "innovation cycle": the continuous process of identifying customer needs and,.through research, design, development and production, translating those needs into products and services. Consumers are being deprived of products and services that could have been made available, were it not for the MFJ restrictions.

Finally, the absence of these products and services lowers productivity for American businesses—contributing to an overall reduction in our nation's ability to compete internationally. Today telecommunications is the core of the nation's infrastructure and it is an important foundation for providing American business the basis for competing in a global economy.

Let me elaborate on these themes. For many years the United States has enjoyed the very best telecommunications system in the world. I believe that we still do. But we risk losing that edge—at great risk to our overall economic competitiveness—unless we change now. What we're really talking about today is the future—and laying out a policy that will serve this nation well in the future.

The statistics tell where we are heading, unless we change our policy direction. The United States' trade balance in communications equipment has shifted from a surplus of over $800 million in 1981 to a deficit of over $700 million in 1990, a difference of over $1.5 billion. Another illustration of the trend is that from 1984 to 1989, 66 American computer and telecommunications equipment companies were bought by or merged with foreign based firms.

What about research and development expenditures—a portent of our future competitive edge? The Bell Operating Companies as a group spent 1.3 percent of their sales on research. While not exactly comparable, the following gives the Committee a sense of how much foreign firms are investing in their future: Germany's Siemens spent 11.2 percent of their sales on R&D; Japan's Fujitsu 10.3 percent; Sweden's Ericsson 11.3 percent.

R&D spending affects the ability of U.S. firms to obtain patents for new telecommunications technologies. In 1980, U.S. inventors received 58 percent of the patents awarded by the U.S. patent office; by 1988 this had fallen to 48 percent of the total. Meanwhile, the percentage of such patents awarded to Japanese interests rose from 18 percent to 31 percent.

Why these striking differences? A major reason is the restrictions embodied in the Modification of Final Judgment. Today we are examining only one of these: manufacturing. Ironically, at a time when American innovation is in question, seven major American corporations cannot design, develop, or manufacture telecommunications equipment. And this problem arises not from a lack of technical capability or commercial interest, but rather from regulatory and legal constraints on the industry.

The manufacturing restriction on the Bell Companies undermines U.S. competitiveness by "sidelining" well over half of the U.S. telecommunications industry's assets. These companies have a strong and deep understanding of customer needs and a clear ability to translate those needs into products and services. In preventing the Bell companies from competing here at home, the manufacturing restriction gives large, highly capitalized foreign companies added incentive to target the U.S. market and exploit this competitive imbalance.

This blunting of our competitive edge occurs at a time when telecommunications has become the backbone of both the commercial and social infrastructures of the 21st century matching the role of the railroads in 19th century America and the highways in the 20th century. At the time these systems were developed, few had the foresight to imagine their potential benefits. Yet that infrastructure had a profound impact not only on the productivity of our economy as a whole but on the

quality of life for individual consumers. We must assure that the same will be true of a modernized nationwide telecommunications network.

Other countries understand this. Japan has established a national priority to completely modernize its telecommunications network. They envision that the majority of households—not just businesses—will have access to high speed data, slow scan video, high speed facsimile and videotext. To achieve this, they have committed over billion to the task—a task they will complete in the next 25 years. The Japanese have a keen understanding that this is a necessity for their economic system to be preeminent in the 21st century. Their investment and their national policy direction provide powerful incentives to that end.

We do not suggest that innovation in telecommunications is the sole answer to American competitiveness, any more than it is to the Japanese. But in S. 173, Senator Hollings, Senator Danforth and the cosponsors of this bill have recognized the significance of telecommunications, have determined to change current policy direction, and have taken a major step forward.

The restrictions of the consent decree have had a major adverse impact on innovation. Many people think of manufacturing in terms of an assembly line or fabrication, and may believe only that we cannot bend metal or assemble telephones. But the ban has been interpreted far more broadly.

The court has construed the ban to exclude us from setting detailed specifications, design and development of telecommunications equipment—even if undertaken through a joint venture or minority partnership. The court has not confirmed whether we can participate in licensing or royalty arrangements. Incidentally—and illustrative of another of our problems—this issue was first taken to the Department of Justice in September 1986 and has been awaiting decision at the court since January 1989.

Not only can we not build a switch, under the court's interpretation, we cannot even write or modify the fundamental software for our network switches, which are giant computers. We have experienced lengthy delays in getting new software for network switches we already own; today we are captives of the switch manufacturers. When we need improvements, we get them according to AT&T's priorities. Wouldn't a little competition from us be a good thing?

Without the prospects of economic return, there is little incentive to engage in market related research and development. And the ambiguity in the manufacturing restriction inhibits research in another way. We are confronted with the threat of a contempt citation or severe financial penalties if we guess wrong about the boundary between research and development. To a scientist or engineer, that distinction is incomprehensible: the essence of the innovation process is the play of information and ideas back and forth all along the path between basic research and marketing.

Effectively, we're prohibited from participating in what I refer to as the "Innovation Cycle": the continual process of designing and redesigning, then developing new hardware, new software, and the full range of products and services this process yields.

Let me give you an example. With current technology, cellular capacity will be exhausted in Los Angeles within a short time. We feel that current cellular equipment manufacturers aren't responding quickly enough to the problem. We're interested in exploring an alternative technology called spread spectrum which would greatly increase capacity over the currently planned next generation of cellular technology. We'd be interested in joint venturing with a small entrepreneurial company to solve the problem.

Yet our options are limited. Because of the MFJ's manufacturing restriction, we're unable to direct the development work of a cellular equipment manufacturer despite our considerable expertise in cellular network design.

Another example is the coin phones of the future—which could be available now. We have detailed knowledge about coin phone reliability, operations, maintenance problems, customer usage patterns and future applications to meet consumer needs. With that background we have convictions about what the public station of the future should be about. It should have the capability to be interactive with the customer, allow the customer access to data base information and have that information printed out on site; a true public information terminal. We have the knowledge to provide this now.

But because of the MFJ restriction, we can't design and develop equipment for a new consumer service that we are confident would enhance the quality of life for its users. The innovation cycle has been blocked. The end result is that the delivery of a clear customer benefit to the market is being delayed. These types of delays and frustrations are repeated over and over and over again.

Our customers—your constituents—deserve more timely and efficient use of our expertise and know-how. And so do our employees. I think it's ironic indeed that

the AT&T worker who comes up with a bright idea on the job can jump right on it. But the worker who happens to work for a BOC is denied that opportunity to innovate on the job.

An example: another customer required a particular device in our central offices called a bunching block. If trouble develops in the system, the bunching block can remove part of the equipment from service without interrupting the total system. Before divestiture, one of our employees figured out a way to make this work better and save him time as well. The employee developed a design, which an outside manufacturer used to manufacture the block. That development work by our employee—had it occurred after divestiture—could have resulted in discipline for the employee at best and a contempt citation for the company and the employee at worst.

So how do you suppose that person will feel the next time he has a creative idea? And what about the customers who might have benefited from a more cost-effective piece of equipment in our offices?

But there isn't going to be much innovation on the job as long as our people are intimidated by concern that they may be breaking the law—the MFJ. We have drilled into all of our employees that they follow the letter and spirit of the MFJ. And we have given them "simplified" guidelines. But just ask yourself, how innovative would I be if I were told that:

"Pacific Telesis may not develop 'firmware' or software integral to the functioning of hardware for customer premise equipment, central office switches, transmission systems or other telecommunications equipment. For example, software generics for stored program controlled central office switches containing algorithms which make the hardware work are considered software integral to the operation of hardware. A Rule of Thumb: Software that is not sold separately from the hardware is probably software integral to the hardware. Warning: Software that is sold separately (e.g. certain switch generic software) may be integral to the operation of the hardware."

Add to that our repeated warnings to our employees that they face criminal sanctions and company discipline if they cross the line and the answer is, I wouldn't dream of trying to innovate anything. And that is just one example from pages of our own internal "simplified" guidelines.

For these reasons, I urge the Senate to pass S. 173. That is not to say that from our point of view, this is an ideal bill. We have made many compromises. But obtaining this freedom, for our workers and for our customers, is so important to us that we are willing to make compromises in order to make progress. But the overriding policy in the bill is absolutely the correct one. Put simply, the restrictions must be removed.

My own view is that this country can't afford to keep Pacific Telesis Group and six other American corporations on the sidelines. We need to unleash the creative potential of our people in the field—people who work on a daily basis to solve millions of customers' needs. Today, America can't put that creative potential to full use.

Is America's standing in telecommunications at risk? Was our auto industry at risk twenty years ago? Our steel industry? Our consumer electronics industry?

We were the world leader in each of these industries. We thought they were safe from foreign competition. American superiority could be overcome.

Senator Hollings, Senator Danforth and the cosponsors of S. 173 have demonstrated more foresight. S. 173 recognizes the realities of the telecommunications marketplace, the economic challenges America faces.

I urge you to pass S. 173. The sooner you act, the sooner we can participate in restoring America's competitive edge.

Thank you.

Senator INOUYE. Thank you very much, Mr. Ginn.

Mr. Kilpatric.

STATEMENT OF JIM G. KILPATRIC, SENIOR VICE PRESIDENT, AMERICAN TELEPHONE & TELEGRAPH

Mr. KILPATRIC. Thank you, Mr. Chairman. I appreciate the opportunity to testify on S. 173, an important legislative proposal, which would significantly alter the competitive structure of the telecommunications industry.

I emphasize that we share the goal of maintaining America's world leadership in telecommunications. But we believe that the

goal can only be assured by retention of the current structural separation between the Bell companies' local exchange monopolies and the highly competitive equipment manufacturing market.

Since divestiture this separation has produced an equipment market in which 5,000 or more manufacturers compete for at least $75 billion in sales—a market that is characterized by easy market entry, dynamic domestic and foreign economic growth, dramatic technological development and ever-declining cost to consumers.

By way of illustration, in the 1980's shipments of telecommunications equipment grew at a compound annual rate of 9.6 percent—double the rate of manufactured goods as a whole. In 1990 the growth rate was even higher, 11.6 percent.

Consequently, there is no need to remove the separation either in order to enhance the country's balance of trade position, to stimulate U.S. technological advantage or to create a role for the Bell companies in the telecommunications field.

To the contrary, our years of experience in this highly competitive postdivestiture market, informed as it is by 20 or more years of experience in trying to defend the very structural integration which this legislation encourages, strongly indicates that repeal of the manufacturing restriction would almost certainly destroy the competitive market to the detriment of balances of trade and technological advancement.

Briefly addressing each of the three asserted reasons for the legislation, first balance of trade.

The U.S. telecommunications equipment trade deficit has almost disappeared, going from $2.6 billion in 1988 to approximately $800 million in 1990. More revealing, if the so-called low-end equipment—telephones, faxes, answering machines and the like—is excluded, the deficit has gone from $100 million in 1988 to a surplus of $1.89 billion in 1990.

As to the country's technological position, last April Dr. Ian Ross, president of Bell Labs, told this committee the United States has the most effective, available, and affordable telephone system and service in the world. In addition, U.S. manufacturers lead in the world in developing high-end technology in an industry characterized by ever-expanding levels of research and development.

For example, the Bell System spent $1.5 billion in research and development in 1981. The companies created out of the divestiture of the Bell System spent over $3.65 billion in 1989. Since divestiture, company-funded R&D investment by domestic telecommunications manufacturers has averaged 8.4 percent of the value of their shipments, compared to only 6.6 percent in 1980.

Also many of the specific areas of AT&T Bell Labs research, which Dr. Ross described have begun to come to fruition. And it is not only AT&T's research. The popular and business press document on an almost daily major technological advancements by large numbers of domestic manufacturers and researchers, including Bellcore.

So, I would submit that no one seriously questions America's technological superiority. Now as to the role of the Bell companies in the telecommunications equipment field, they rightly play a legitimate role as users and purchasers. They help to set technical

standards for the industry. Collectively they represent some 80 percent of the market for exchange network equipment.

Again collectively, they represent well over 50 percent of the market for cellular equipment, and given their role which the MFJ permits as providers of customer premises equipment, they are a substantial portion of that market as well.

Moreover, because they determine the characteristics of and interconnection requirements of their networks—and thus what products are compatible with it—they strongly influence the equipment purchases of independent telephone companies and the features and functions of every product to be used with the local networks, from telephone to computers to television transmission equipment, for example.

It is a simple economic fact, no prospective supplier of network equipment can hope to be successful unless it attracts some business from a Bell company. And no prospective supplier of any other telecommunications equipment can hope to be successful, unless it can both obtain timely access to technical information about the Bell network, and have its products succeed or fail on their own merits, that is on their price and quality.

I am not here to bash the Bell companies. I respect their expertise and their performance in their present multiple roles in this field. I am only concerned if they become manufacturers while retaining their local service monopolies, the incentives and opportunities for anticompetitive conduct are unavoidable.

I come to that conclusion in considerable part based on the allegations made against the Bell System's integrated structure during the litigation that led to the MFJ in the first place. Those claims were that prospective manufacturers were deterred from competing in three types of actions by the Bell companies.

The allegations were that one, they favored the in-house manufacturer with advanced access to technical information. Two, they improperly subsidized design and development costs with local exchange revenues. And three, they conducted biased product evaluations for procurement that favored in-house designs irrespective of price and quality.

Whether or not those allegations were true, the perception that the Bell System operated in this manner was apparently enough to limit competitive entry and R&D investment as indicated by the significant growth in these measures after the MFJ was announced.

We see no assertive benefits for the legislation which would in any way offset these very serious risks to the current benefits of competition, which experience teaches we should expect if it is passed.

Thank you.

[The prepared statement of Mr. Kilpatric follows:]

PREPARED STATEMENT OF MR. JIM G. KILPATRIC

Mr. Chairman and members of the Subcommittee: My name is Jim G. Kilpatric. I am Senior Vice President—Law of American Telephone and Telegraph Company ("AT&T"). We appreciate the Subcommittee's invitation to appear today to discuss S. 173, The Telecommunications Equipment Research and Manufacturing Competition Act of 1991. This bill would eliminate the AT&T Consent Decree (also known as the Modification of Final Judgment or "MFJ") prohibition against the manufac-

ture of telecommunications equipment by the divested Bell Regional Holding Companies ("RHCs") through affiliated companies. The FCC would administer and enforce newly-developed regulations intended to prevent abuses of the local telephone service monopoly.

I appreciate the opportunity to testify on this most important piece of legislation which would significantly alter the basic structure of the telecommunications industry. The issue before this Subcommittee is how best to assure that the United States continues to maintain world leadership in telecommunications—how to ensure the international competitiveness of this sector of American industry.

First, let me say that we all share Mr. Hollings' goal of maintaining world leadership in the U.S. telecommunications equipment manufacturing industry. We want to produce the best products, provide the best service, and foster the best new technologies right here in America. This means we need an equipment manufacturing industry that is characterized by competition, technological innovation, economic growth, and declining costs for consumers.

For us those are not empty words. Since the breakup of the Bell System, AT&T has faced vigorous competition in all our products and services. That was one of the chief purposes of divestiture. For us, competing on quality, price, and service in our markets drives our business and our determination to be a world leader.

Last year, when we testified before you, AT&T broadly addressed this question—the role of the Decree in the telecommunications equipment markets. We also attached comments on our nation's telecommunications infrastructure filed with the National Telecommunications and Information Administration (NTIA), describing our view on the right policies to insure a vigorous, competitive telecommunications industry.

However, the debate here before your Subcommittee is not about that goal, which we all share, but how best to achieve it. The questions you are considering have been raised in years past, and have been the focus of numerous hearings, dozens of pieces of legislation and countless legal proceedings. Do we maintain the current structure, keeping the local monopoly segment of the industry controlled by the Bell companies separated from the fully competitive manufacturing industry? Or do we allow the Bell telephone companies to add manufacturing to their local monopoly, and rely on heavy regulation to control potential problems?

The proposal before us, S. 173, would change the current structure and take the latter course, allowing the Bell telephone companies to manufacture, while retaining their local monopolies, and relying on regulation through the FCC to patrol for abuses. We must ask, however, why is there this need for change? Just what is it that needs fixing?

Today my testimony is divided into two parts. I will address the status of the telecommunications equipment manufacturing industry and explore these questions: What is the current outlook of the telecommunications equipment manufacturing industry and in what direction is it heading?

What do the most recent statistics show? Does the data support the need for change?

Then I will focus on the consequences of allowing the Bell companies to manufacture, as proposed by S. 173, and review these issues: What would be the effect on other telecommunications equipment manufacturers if the Bell companies were released from the manufacturing prohibition in the Decree? What were the experiences in the past, before divestiture, with regard to problems caused by monopoly control of both the local bottlenecks and manufacturing? How would increased regulation, as proposed in S. 173, safeguard against potential abuses from cross-subsidization and other concerns? Would competition in telecommunications equipment manufacturing benefit from the entry of the Bell companies? What manufacturing expertise do these companies bring to the table?

Finally, I will close with how we believe the Bell companies can play an important role to strengthen American manufacturing. Such a role does not require legislation like S. 173.

I. THE STATUS OF THE TELECOMMUNICATIONS EQUIPMENT INDUSTRY

Proponents of S. 173 seemingly have an understanding of the telecommunications equipment manufacturing industry based on several erroneous assumptions: That this part of the economy is on the brink of disaster, that America is losing its technological lead in communications, and that the evidence is that we have a significant trade problem.

Mr. Chairman, we and others in the manufacturing side of the industry profoundly disagree. We disagree not just on principle, but because the assumptions are sim-

ply not correct. The statistics show a dynamic, vibrant industry. Let me share some of the facts with you and the Members of the Subcommittee:

- In the decade of the 1980s, communications shipments had a compound annual growth rate of 9.6 percent, double the rate for manufactured goods as a whole. In 1990, even with the effect of the beginning of the recession, the growth rate for the non-defense communications equipment sector was 11.6 percent.
- In 1989 and 1990 we witnessed a 70 percent drop in the trade deficit from 2.6 billion in 1988 to only $.8 billion in 1990. U.S. exports jumped sharply—a 29 percent average annual growth rate for the same period. And, foreign imports leveled off, increasing less than 2 percent in 1990.
- In the critical product category of switching equipment used in telecommunications networks, the U.S. trade surplus increased from $115 million in 1988 to $710 million in 1990. Mr. Chairman, this is an increase of over 500 percent in just a two year period. I would characterize such growth as astonishing.

The largest trade association in the industry, the Telecommunications Information Association (TIA) is also testifying regarding the health of our industry, and will no doubt confirm and add to what I have told you.

AT&T came here last year, Mr. Chairman, and testified that this segment of the manufacturing industry was healthy, competitive and growing. A look at the latest trade statistics alone will tell you that the American telecommunications equipment industry is healthy, competitive in world markets, and getting even stronger.

Ours is not an industry on the brink of disaster. The direction in which our telecommunications equipment manufacturing industry is heading has shown a consistent pattern of improvement, at the very heart of America's financial strength. The data does not support a need for change.

I am proud to say, unequivocally, that the U.S. telecommunications manufacturing industry is the best in the world. And, Mr. Chairman, our company is proud to be part of it.

II. CONSEQUENCES OF ALLOWING THE BELL COMPANIES TO MANUFACTURE

Let me turn to the local telephone companies. Let me say first that I am not here today to criticize the Bell companies. Those companies, along with GTE and the 1400 independent telephone companies which control the local networks are, without question, the best at providing local service in the world. Indeed, they are the envy of the world. They have over a hundred years of experience in providing local service. Their record of quality service provision and telecommunications networking expertise speaks for itself. They are sound companies, contributing importantly to our telecommunications infrastructure.

Both of these industry segments, telecommunications equipment manufacturing and local telephone service provision, are now performing well and cooperatively. We in the manufacturing sector, AT&T and literally thousands of other companies, sell the telcos the equipment and technology with which they provide the fine service we all enjoy. Now the question is, what is to be gained by releasing the Bell companies from the restrictions of the MFJ, permitting them to manufacture, and increasing the regulation of the resulting combination? We, and many others in our industry, think that it would not be helpful to manufacturing and could cause serious problems. Let me tell you why.

The three principal problems engendered by this bill are that the Bell companies, by virtue of the control they have over the local monopoly network, are in a position to recreate the problems of the past: to discriminate against existing manufacturers by providing preferential access to essential technical and engineering information about the local exchange networks to their own affiliates, to purchase their own affiliates' equipment regardless of the price or quality of competitor's products, and to cross-subsidize the cost of their own products with monopoly ratepayer money.

First, if S. 173 or a bill like it becomes law, the Bell companies would continue to set their own technical or compatibility requirements (as they do now), and, further, would have the opportunity and incentive not to communicate these requirements adequately or in a timely fashion to their competitors. That would give the Bell Companies' own manufacturing affiliates a "headstart" and insuperable advantages in designing equipment for use with the Bell controlled local exchanges. This headstart would assure that their manufacturing affiliate would be the first to have products on the market, uniquely designed to meet the Bell companies requirements. Beyond this, if the product's development were to have been subsidized by ratepayer funding of the Bell's closely-related research and network engineering activities, the product could appear to have a cost advantage which is, in fact, artificial and unfair. Regulatory authorities in the future, as in the past, would have great difficulty with this set of problems. A massive set of regulatory rules and pro-

ceedings in the past could not deal with these issues, and their return in a new form would only add more regulations to the industry without spurring competition. S. 173 does not deal with these problems adequately, much less solve them.

What's more, if the Bell companies are permitted to manufacture their own equipment, what is the incentive for a non-Bell firm to invest in R&D and new technology in such a market? The incentive is much reduced if the non-Bell manufacturer risks losing Bell sales to the Bell-affiliated manufacturer, regardless of the merits of the products. The health of the manufacturing industry as a whole would likely go into decline, because much of the growth in today's R&D has been based on the assumption that there will be no favoritism for an "in house" supplier.

Second, there are a whole array of problems connected to cross-subsidies, funds derived from captive ratepayers, supporting the development of competitive products.

The Bell companies would have the same incentive the Bell System had to subsidize the prices of manufactured equipment with the revenues from their monopoly services. The Bell companies would be in a position to provide customer premise equipment to their customers below cost and to conduct affiliate sales to themselves at below-cost prices when necessary to ensure that the Bell products would be selected. Specifically, the Bell companies would be in a position to charge or allocate the engineering, research, product design and development expenses to the local telephone affiliate by including them in the rate base for local telephone services—using means such as the Bell System's License Contract which was alleged to be a vehicle for allocating product development expense to the cost of research and network engineering.

Problems of cross-subsidization and costs wrongly allocated to the ratepayer are and have been the subject of FCC and public utility commission proceedings across the country for many years. But, the regulatory commissions with the responsibility to monitor what goes into the rate bases often confront a monumental task as they wade through labyrinths of different accounts, rooms full of documents and data, and an intricate series of judgments over allocation of costs. Time and again state and federal regulators have complained about the difficulty of obtaining such information from the Bell companies. Even if they were able to get all the data, second guessing these judgments are difficult or impossible.

Given the reductions in budgets and staff at the FCC and the state commissions to do what presently needs to be done and the elimination at divestiture of specific procurement and manufacturing cost regulations, is it reasonable to expect regulators at the state or the federal level to oversee an entirely new area: Bell manufacturers? We think not. There is no expertise in manufacturing at either the FCC or the state commissions, and no history to believe they can acquire it. In fact, there is no economic regulation of manufacturing anywhere in our economy today as proposed by S. 173.

This bill would significantly increase regulation of the Bell companies and any affiliated manufacturers. We in the industry view this possibility with great alarm. This creates problems; it does not offer a solution.

S. 173 thrusts an array of new regulatory requirements on an industry which is now one of the most competitive in the world, and which does not currently need such regulations. Regulation of carriers to reach an affiliated manufacturer never ended the controversies before. The failure of this regulation was one of the reasons we had the Bell System breakup. The regulatory body that would be charged with this behemoth task in S. 173 would be the Federal Communications Commission (FCC). Roughly, three-fourths of the Bell assets are regulated at the state level. S. 173 would de facto increase the burdens that fall onto the state commissions, already operating under drastically reduced budgets and staff. We are skeptical that anything other than a closed market could emerge.

Third, as long as there is a ratepayer-funded local monopoly, there are major self-dealing dangers for both ratepayers and non-affiliated manufacturers. In the antitrust suit, the Justice Department claimed that when Western Electric's "privileged access to information [and other conduct] failed to foreclose competition", the Bell companies would simply favor their affiliates' products, even when better or less expensive alternatives were available from unaffiliated vendors. In episode after episode, the Justice Department charged this misconduct and alleged that the monopoly character of the Bell-controlled local exchanges gave them the ability to buy equipment at inflated prices, to the detriment of competition and consumers alike. The Justice Department argued such a use of vertical integration to "evade" rate regulation and inflate consumers' rates was a violation of the Sherman Act.

If the Bell Companies take their manufacturing "in house", as S. 173 would permit, there is sound basis to fear a re-emergence of the self-dealing controversies of the past. In other words, if your company is not the affiliated Bell company, that

part of the market is closed to you. Because the Bell companies control 70-80 percent of the local network market in the U.S.—100 percent in their franchised areas—it is apparent that this is a very large and real problem for independent manufacturers.

But, let me be quite clear: when the monopoly power ends, when the local service markets are as competitive as the long distance markets, we would have no objection to Bell companies entering manufacturing. We believe the major problems we have discussed would be much less troublesome if the monopoly power dissipates.

This leads to yet another question: what competitive manufacturing expertise do the Bell companies bring to the table? They candidly admitted here last year that they have none. The record contains a very clear statement on this subject by one of the Bell CEOs, John Clendenin from BellSouth. In response to a question from Senator Inouye, in April 1990, Mr. Clendenin said, and I quote, "We have no expertise in manufacturing". Manufacturing in the Bell System was done by the Western Electric Company, not the local telephone companies. That manufacturing expertise remained with Western Electric following divestiture.

The Bell companies could hardly begin manufacturing high tech telecommunications equipment by starting their own operations from scratch. The only practical approach for any company to enter this high-tech, capital intensive business would be by acquiring or joint-venturing with an existing manufacturer. Since divestiture, most if not all of the Bell companies have established separate alliances with various large foreign manufacturers anxious to gain footholds in the U.S. If the Bell companies were to joint-venture with their foreign partners, non-aligned U.S. manufacturers would lose out, with disastrous effects on U.S. trade.

III. CONCLUSION

If the Bell companies do not have manufacturing expertise, do they have skills in telecommunications and networking? Certainly they do. And is there a role for the Bell companies in manufacturing? Certainly there is. We need their considerable expertise as users, purchasers and service providers so that we can produce even better network and customer equipment. We need them to work closely with us and others as we design and fabricate products. We need the telephone companies and manufacturers to work together better as partners and the current industry structure allows all this. We do not need legislation to do this. We do not need the telephone companies to close markets and bring back regulation by becoming manufacturers. In short, we believe that S. 173, as presently written, presents the industry with a great deal of risk and very little potential benefit. It will not do what it is designed to do, namely, increase American international competitiveness.

Senator INOUYE. Thank you very much.

Mr. Ginn, much as we would like to assume that major corporate bodies in this Nation are law abiding, I think the facts indicate that when given the opportunity, corporate entities have been known to violate laws, to violate provisions of court orders and such. Recently we saw violations by NYNEX and U.S. West. RBOC's still maintain a monopoly position over local telephone use, and the Government Accounting Office tells us that the FCC has the capability of auditing telephone companies once every 16 years.

Do you believe that there is an incentive, and an ability on the part of telephone companies to abuse their monopoly position?

Mr. GINN. Senator, I guess I have to start from a philosophical level, and tell you that upon becoming chairman of Pacific Telesis in 1988, the first speech I made to all the employees was on business integrity. Because my greatest fear was that we would get caught up in some kind of violation, and you can see how easy that would be from what I read, and that we had a very special obligation, given the role that we play, to our customers.

Beyond that, I think it is sound business principle to be absolutely within the letter and spirit of the law, because in my business if you violate the law, and customers begin to say that you are not doing the job for them, what you find very quickly is that regulators and legislators and consumers are on top of you in a minute.

So, I would start all this with a basic premise that if you do not have business integrity, then nothing else is likely to work properly. And so we have great incentives, I think, in my business and I believe all the RBOC's to follow the laws as best we can, because it is in our business interests to do so.

Senator INOUYE. Opponents of this measure suggest that RBOC's have very little manufacturing experience, and therefore would very likely either acquire manufacturing companies, or enter into joint ventures. And the prime candidates for these joint ventures would be in, all likelihood, foreign firms—and that this will increase the foreign presence in the United States.

Furthermore, it would very likely result in having a monopoly situation whereby you will manufacture and buy from yourselves at inflated prices, and sell to other at deflated prices, and thereby acquire a monopoly.

Are these charges valid?

Mr. GINN. I do not think so. Let me start with the first one, manufacturing expertise. You know in 1984, we had no expertise in cellular network engineering. Yet today, 200 engineers from my company are engineering a cellular system for the Republic of Germany. So, we learned to grow.

But that is not the more important issue to me. The more important issue is the innovation cycle, and let me go back to that, because I think it is important.

You see, we are out there with customers. We understand customer needs. And what we need to be allowed to do is translate those customer needs into products and services that satisfy the consumer.

Now when you do not let us participate in that innovation cycle, I think everybody loses. We lose. The consumer loses. Jobs are lost. And our competitive position is lost. So, I think it is not a good argument to say, you do not have manufacturing expertise, because that is not the issue. The issue is the innovation cycle, and being able to translate what you see in the market to customer needs.

Now, you had some other issues I have forgotten, or did I answer your question?

Senator INOUYE. That you will just manufacture and buy from yourselves at inflated prices and sell to others at deflated prices.

Mr. GINN. Well, I think at least my reading of the proposed legislation does a very, very good job of dealing with all the self-dealing issues, so I do not think there is a possibility to do that.

Nor is there an incentive. I just want to assure you. You know we have many affiliate transactions today involving the Bell operating company with other affiliates of Pacific Telesis. Those affiliate transactions, I can assure you, are monitored extremely closely by the California Public Utility Commission. As was also said, the FCC monitors us, and any manufacturer that feels that they have been disadvantaged can go see Mr. Rill.

I do not think there is any set of companies that gets more oversight than the regional Bell operating companies.

Senator INOUYE. Mr. Kilpatric, it has been suggested that this bill is necessary, because the United States is losing its leadership in the high-technology industries. For example, they maintain that the regional Bells spend about 1.4 percent of their revenues on

R&D, whereas comparable companies in Japan and Germany spend over 8 percent.

They also point out that foreign manufacturers have increased their U.S. market share from 17 to 21 percent over the past 5 years. That foreign manufacturers have purchased 66 high-technology businesses over the past 5 years. And between 1980 and 1988 the percentage of U.S. patents awarded to U.S. companies dropped from 58 to 48 percent. And the percentage of U.S. patents awarded to Japanese companies rose from 18 to 31 percent.

Do you have any comments to make on those statistics?

Mr. KILPATRIC. Yes, beginning with the comparable research and development figures for Bell companies as compared to overseas. The comparisons I have seen have usually been between a Bell company, which provides a local exchange service, and an overseas manufacturer.

It seems to me a more apt comparison would be between the Bell operating companies providing local service here and a bundesposte, for example, providing telephone service in Germany. I do not have what those figures are, but it seems to me it is a more apt comparison.

Turning to an increase in percentage of sales in this country by overseas suppliers, a considerable part of that increase in foreign sales here came at the expense of my corporation. I understand the purpose the MFJ to be to drive down the market share for AT&T.

That occurred. But simultaneously with that these thousands of new companies, new manufacturers, have arisen in the United States. If we will give the decree enough time, it is already clear that they are going to regain the sales in this country.

You ask about purchases of high-tech firms by foreigners. That is not a unique phenomenon to the telecommunications industry. Perhaps 66 is too high, but I am not convinced that the provisions of this legislation would change that.

Finally on patents, it is very important to me to try to maintain myself current on what is happening in patents, because so many of the lawyers who work for me are at Bell Labs. Interesting thing has happened since divestiture that has affected the philosophy of patenting inventions.

When there was very little competition for the Bell System, every invention by and large was put through the patent proces. Because the pace of innovation in the system was considerably slower than it is now. As we have faced increased competition, we have shifted to patenting first those inventions which we expect to put to commercial use in the marketplace, and if we can early on in the process choose as between recent inventions, we will go with the one that we know is going to be our flag carrier in a competitive marketplace.

Some of the foreign countries you mentioned still are very much in a situation where they do not fact very much internal competition. So ,it does not surprise me that there would be some differences. I am convinced that, for my company, our level of patents is absolutely right for the market conditions that we confront.

Senator INOUYE. Thank you very much.

Senator Hollings.

The CHAIRMAN. Thank you, Mr. Ginn. I reviewed your testimony on last evening, and you have covered, under the chairman's questioning, Chairman Inouye's questioning, the part about the self-dealing and the fact that it is just not good business, much less trying to make a lot of money. So, I am going to pass with you, sir, because the hour is late and we got another panel right in behind you.

And Mr. Kilpatric, of course there are 1,400 telephone companies in the United States, and the seven Bells are the only ones prevented from manufacturing. You have got 70 percent of the market, and the only competition in a way you had there was GTE in manufacture. Now you have got their manufacturers. Sprint is not in it. MCI is not in it. And you are only one of eight on switching equipment in the world. And you are the only U.S. participant.

Can I characterize your testimony to the committee as saying, please help me keep my monopoly I have got here as a U.S. company?

Mr. KILPATRIC. No sir, absolutely not. In the first place, AT&T does not have a monopoly in any of the markets in which it participates. The 70-percent figure is too high for any market we are in. I do not know the particular one to which you refer.

The CHAIRMAN. Long distance.

Mr. KILPATRIC. Long distance, the more correct figure is in the sixties for some parts of the business, barely above 50 for business. So, it is very competitive, and it fluctuates often, as it should, given the intentions of the decree. There is no other business that is dependent on us as a sole source of supply for anything we supply, as is true for manufacturers for the local exchange.

The CHAIRMAN. Well, I think my main concern here is not trying to get a balance of trade, or watch the sense or the direction or anything else. More than anything else, I differ with you most respectfully about the technological superiority.

We know differently. We continue to lose that, the train is totally in the other direction there. We just got a technological victory here, in Iraq, and I do not want to list all the items, but we have got them on the Defense Appropriations Subcommittee, which our distinguished chairman chairs. And if it were not for certain ships and everything else, you would not be hearing about Japanese technology, by the way, that we do not have.

We depend on foreign manufacturers for a good bit of that Patriot missile and that Tomahawk missile and several of the other things that have been bantered about in the press. So, these are the kind of things that bother me; we are losing technological superiority position, if there is such a thing at the present time. And that is really the genesis, then, of this bill, we have the capability to allow seven outstanding companies to come into the manufacturing market, trying to maintain that technology here in the United States, as well as the jobs and manufacturing and everything else of that kind.

You want to comment on that, Mr. Ginn?

Mr. GINN. I was just going to add to a comment that was made about all their markets are competitive. I think what Mr. Kilpatric said is true, but there is one slight modifier. Once an operating company buys a central office switch, then through the life of that

switch, the software that drives it gets revised, we call these generic updates. And there is no alternative supplier for that. You must buy that company's generics through the life of that system, which can be up to 25 years. The MFJ, in effect, gives AT&T a monopoly for the life of the switch. So, I think that needs to be added in the context of what he said.

The CHAIRMAN. Thank you much, Mr. Chairman.

Senator INOUYE. Senator Pressler.

Senator PRESSLER. Thank you, Mr. Chairman. I shall ask most of my questions for the record, because of the late hour. Mr. Kilpatric, explain to me why AT&T objects to the Bell companies being allowed to manufacture telecommunications equipment, because of their involvement in a regulated phone market, when in fact AT&T is also involved in a regulated phone market.

Mr. KILPATRIC. It is not that they are engaged in a regulated phone market. It is that there is no competition for the local distribution service which they provide.

Senator PRESSLER. OK, so you consider yourself in a different situation.

Mr. KILPATRIC. Absolutely different.

Senator PRESSLER. OK. Mr. Ginn, I understand there is an amendment being circulated that would allow the Bell companies to be involved in all areas of manufacturing, except actually bending the metal. Is there any middle ground here?

Mr. GINN. Well, I just saw that a few moments ago, and I am a little hesitant to give you my view on it. But in my general reading of it, it just does not open a door to us. It does not allow us to participate in the innovation cycle that I have mentioned three or four times.

It is basically an empty proposal and if the idea is to take the capabilities, the creativity and innovation of these Bell companies, and have that translated into consumer products and services that benefit consumers, I think that proposal pretty much undermines it.

Senator PRESSLER. Thank you, I have some additional questions; I will submit them for the record.

Senator INOUYE. I will advise all of the witnesses that we may be submitting additional questions, for your concern and consideration. Senator Breaux?

Senator BREAUX. Thank you, Mr. Chairman, and thank the members of the panel for being with us.

Mr. Kilpatric, when did AT&T reach the position of affirmatively advocating and supporting a prohibition on the regional Bells engaging in manufacturing?

Mr. KILPATRIC. The original draft of the MFJ submitted to AT&T by the Department of Justice in December of 1981 contained the restriction on the Bells as to manufacturing. And as I recall the cover letter, it said that the restriction is the reverse of the divestiture itself. It will maintain the divestiture, and is not negotiable.

Senator BREAUX. And that is when AT&T started supporting it?

Mr. KILPATRIC. It was part of the transaction. The evolution of the market since divestiture, with the increase in technology, the increase in participants and the recognition that the reason most of these new entrants have come around is because they believe the

premise that there will not be an overhang of the market by the provider of local service also entering into manufacturing. That makes it all the clearer that that provision is correct.

Senator BREAUX. I am sorry. That confuses me, because I am looking back at a hearing that the Federal Communications Commission had back in 1982, a year after the time that you just spoke to, in which Howard Trenens, who was your general counsel in that time, was being questioned by Mark Fowler before the Federal Communications Commission about the business restrictions that were part of the 1981 agreement that you had just mentioned.

And Mr. Trenens, in response to Mark Fowler, said—and I would ask you to comment on it after we get it on the record—Mr. Trenens was saying, "We do not want restrictions on the Bell operating companies; that was not our idea."

And he goes on to say, following up by Fowler about the restrictions, says, "Well, let me preface it again by saying that the restrictions was not our idea. We would be happy to have them unrestricted."

And Fowler continues, saying, "Your position would be that you would be happy to not have any restrictions?"

And Trenens says, "Yes, sir, they were not our idea."

And Mr. Foggerty, I guess, who was a commissioner at that time, went ahead and asked additional questions about the business restrictions, and he asked Mr. Trenens again, saying, "I tend to agree with you, Mr. Trenens, that no undue restrictions should be placed on the companies, and you by the same token, I was pleased to hear that you did not volunteer to restrict the divested Bell operating companies from participating in these competitive enterprises."

And he continues and says, "So I take it you would not object if the commission should suggest to the court that that sort of restriction should be removed from the BOC's once divested."

And Mr. Trenens says, "Not at all."

Mr. Brown—Charles Brown, I guess—was asked that very question before a national association of regulatory utility commissioners group, and he said that it was not our idea. And the question was, well if the Justice Department agreed to eliminate those restrictions, would you agree. And the answer was, of course.

Well now, in 1991, the Justice Department agrees, and my question is, I am confused as to AT&T's change of position, apparently.

Mr. KILPATRIC. Let me see if I can explain. It is absolutely clear, as I just indicated, they were not our idea. They were part of the draft when it came. At the point when Mr. Brown was speaking before the trade association, and Mr. Trenens were speaking before the FCC, they were, respectively, chairman and general counsel of the Bell System.

They were dealing with a set of assets that the Bell System was to split up. The terms and conditions of the agreement that had been reached with the Department of Justice and which was then before Judge Greene in the Tuniac proceedings, included the restrictions. We did not fail to understand the reason they were there. But speaking as he was for all of the assets, if it had been possible to get the arrangement without those restrictions, the Bell System would have been happy to take it.

Senator BREAUX. I think it clearly indicates that at one time, the chairman of the board and the general counsel were saying before the FCC that they had no problems with the business restrictions, that if the Justice Department said they could be removed that you would, in the words of Mr. Trenens at that time, have not at all, no problems. Well, if Justice agreed to eliminate the restrictions, would you agree? And the answer was, of course.

And I am just confused as to the position today. It does not seem like you are in favor of that position.

Mr. KILPATRIC. And not just AT&T. Since that time, a whole industry has been created with not just AT&T participating, but with thousands of others. And so to reverse the premise upon which we have made commitments, and investors have given us their wherewithal, and the same with many other corporations at this point, seems to me to be much too late, particularly when there are no perceivable benefits from the legislation.

Senator BREAUX. OK, let me ask a couple of other questions shortly, in a short time frame. Dealing with jobs and manufacturing, because that is the issue of the hearing, and ask you if the statement is correct, and if it is not correct, please correct it for me, because we are talking in a pamphlet that I have seen that says as the source for this information, AT&T Annual Report to Shareholders, and the AT&T Form 10–K reports. I am not too sure what that is, but that is what they cited as a source.

And they say in talking about the decline in AT&T's domestic manufacturing since the divestiture, the statement is AT&T has closed five production plants in Baltimore, MD, Cicero, IL, Indianapolis, IN, Kearney, NJ, and Winston-Salem, NC. Now, is that correct, or if it is not correct, please straighten it out for me.

Mr. KILPATRIC. It is correct.

Senator BREAUX. Another question I have to ask, and the source for this is the same two sources that I read on the first line of the previous question. In the statement there is some elaboration here, now I am not asking about this, it says, rather than rebuild the domestic plant and equipment, AT&T chose instead to go foreign.

But the question I want to ask is whether this is correct. Investing in major foreign joint production ventures based in Europe and Asia, and four wholly owned separate manufacturing operations located in Ireland, Hong Kong, Singapore, and Thailand.

What of that statement is not correct, if any of it is not correct?

Mr. KILPATRIC. The sites you mentioned are, so far as I am aware, places where AT&T has factories.

Senator BREAUX. OK, now make it more parochial from a Louisiana standpoint. One of the articles one of the papers dealing with your Shreveport installation in Shreveport, LA. It was an announcement I am reading from a newspaper article. It said that it was an announcement, AT&T says it will lay off 330 workers at its plant here by March 30. And the article continues. The layoffs are the result of AT&T's decision announced in 1988 to phase out the manufacture of pay telephones in Shreveport. The public phones will be manufactured for AT&T in Taiwan. The latest layoffs will leave the plant with about 2,500 workers from a peak of 7,500 workers in 1974.

The question I need you to comment on if you could, is the amount of workers that they say was approximately 2,500 from a peak of approximately 7,500 in 1974. Is that approximately correct or incorrect?

Mr. KILPATRIC. I cannot verify from my own knowledge. I would be happy to provide that.

Senator BREAUX. Well, from your own knowledge, well maybe you have no knowledge about it, it is not your area of personnel. But does that sound about the size of the reduction of the workers in the Shreveport, LA plant?

Mr. KILPATRIC. I simply do not know, but I will find out.

Senator BREAUX. OK, because I said something in my opening statement that it was a reduction of about 60 percent in the Shreveport plant. This figures out about 66 percent, if it is correct. I am not sure it is, because I am only quoting from newspaper reports. Thank you.

Mr. KILPATRIC. Senator, could I make a comment about plant reductions and closings, and the reasons for them?

Senator BREAUX. I have heard the reasons. You are welcome to restate them. I am just trying to verify whether they in fact occurred or not.

Mr. KILPATRIC. A big reason is the increased competition. As I mentioned before, one of the purposes of the decree was to reduce AT&T's market share, which necessarily means sales are reduced, which means production is reduced.

Senator BREAUX. Well, let me ask you on that point, are you reducing production? Or are you just reducing production in the United States, if you are opening plants in Singapore, and in Taiwan and in Hong Kong and in Ireland. It sounds like you are not reducing production; you are just reducing U.S. production.

Mr. KILPATRIC. For the low-end equipment, I know of no manufacturers who are selling telephone sets in the United States who are manufacturing them here. That is one reason for going abroad.

Another is, as we try to sell to overseas telephone administrations, very often, one of the conditions of their considering our sales pitch is that we open facilities in their countries.

Senator BREAUX. Well, how much of your offshore production is sent back to the United States in terms of imports?

Mr. KILPATRIC. I cannot give you the figure, but I will provide it.

Senator BREAUX. Do you have an approximate idea?

Mr. KILPATRIC. I do not.

Senator BREAUX. How much is the trade deficit in manufacturing?

Mr. KILPATRIC. The trade deficit?

Senator BREAUX. Yes, on telecommunications equipment?

Mr. KILPATRIC. For AT&T?

Senator BREAUX. Yes.

Mr. KILPATRIC. I could provide that figure as well.

Senator BREAUX. OK.

Senator INOUYE. Senator Burns.

Senator BURNS. Thank you, Mr. Chairman.

Let us proceed along the line that Senator Pressler opened up here just a little while ago. As you know, there are some proposed

amendments or compromises that could possibly make this more compatible to both parties that are concerned here, which is basically AT&T and the Bells.

Mr. Kilpatric, would AT&T be willing to live with legislation that permits the Bell companies to participate fully in the design and development, but stop short of permitting the Bell companies to fabricate the equipment? In other words, would you be willing to accept the—I think it was a compromise circulated by the Digital Equipment Corp. That was done last year, I think.

Mr. KILPATRIC. Senator, the vast majority of the allegations made against the Bell System in the antitrust suit brought by the Department of Justice focused not on the fabrication part of the manufacturing process, but on the design and development portion. It is the least obvious phase and so hardest to detect, and I think it is highly improbably that we could ever agree to that.

Senator BURNS. Mr. Ginn, you heard the question and his answer. What is your view on Pacific Telesis and the Bell companies—are they willing to compromise?

Mr. GINN. Well, I opened my comments by saying that I am speaking for six other partners, and I would hate to commit to them at this moment about what we were willing to do and not willing to do. But the thing that bothers me about that, I mean, we can do research and produce functional specs today. So that is not giving us anything.

The whole issue is, how do you get your bait back? I mean, what is the incentive for us to invest in research if there is no opportunity to earn margin on equipment that you sell? And the answer is, you do not do the research if you do not have the opportunity to get your bait back, either through royalties, licensing fees, or selling the product. So that is why I called it empty.

You know, if this turns out to be our national policy, nothing will happen, nothing will happen.

Senator BURNS. Mr. Kilpatric, is it true that AT&T's research and development expenditure declined 8 percent last year? I was following up on Mr. Kerry's questioning over there. Is that a correct statement?

Mr. KILPATRIC. I believe it to be an incorrect statement.

Senator BURNS. Could you enlighten me on that?

Mr. KILPATRIC. I do not have the final 1990 figures, but I would be happy to supply them.

Senator BURNS. We will probably have a couple more questions, because one thing leads to another, and we are going to miss supper. I have never missed a meal, nor do I intend to. [Laughter.]

So that will complete my questions. Thank you, Mr. Chairman.

Senator INOUYE. Senator Kerry.

Senator KERRY. That is a hell of a preface to my rounds. I have known pressure, but never such pressures as the stomach. I am just going to ask a few—and Mr. Chairman, I know there is another panel, and I do not want to keep everybody late either.

So, I gather we are going to leave the record open? So we can submit questions?

Senator INOUYE. Yes.

Senator BURNS. Mr. Chairman, I have some stuff to submit for the record, here. May I do it at this time? There are a couple of

articles, "No Answering Machine"—came out of Business Week—and the "Smarter Way to Manufacture." I would like to have those entered into the record.

[The material referred to follows:]

[Business Week, Dec. 3, 1990]

No Answering Machine Ever Looked Like This

(By Joan O'C. Hamilton, Menlo Park, CA)

When American Telephone & Telegraph Co. engineers showed Product Manager David Dubbs the digital workings for a snazzy new phone-answering machine, he felt sure it could be a blockbuster. Trouble was, getting it ready for this Christmas season meant Dubbs had to get the product designed, manufactured, and shipped in less than a year.

Dubbs turned to frogdesign, where tackling unreasonable deadlines helps the firm justify some of the highest fees in the business. Dubbs spelled out his needs to Design Director Daniel Harden in mid-December. Then he added, "We want mystery and magic in it."

The first 2 weeks of January, Harden and designer Paul Braund, who has since left frog to start his own firm, locked themselves in a brainstorming room. In sessions that dragged late into what from employees call "0-dark-hundred hours," Harden and Braund noodled, doodled, and sketched the possibilities.

FINE TUNING

As the choices narrowed, model makers joined in. The simple process of turning sketches into 3–D forms helps shape design issues. In the first model phase, white-foam forms are made, often assembled in hours by knife-wielding sculptors. By January 15, Harden and Braund carried seven foam-model options, including one contributed by frogdesign Chairman Hartmut Esslinger, to a meeting with 15 AT&T manufacturing engineers in Indianapolis. The engineers pronounced the designs manufacturable. The stylistic elements wouldn't make the machine too difficult or expensive to produce. The clear favorite of the AT&T crew was Braund's vertical concept, which came to him when he glanced at the portable compact-disk player he had turned on its side on his desk to save space.

By January 31, frogdesign showed Dubbs another of its secret weapons: a fully detailed scale model of the design. Early on, Esslinger invested in a state-of-the-art computer-aided-design system hooked up to a computer-controlled milling machine. Model makers sit at terminals in a dim room, precisely measuring specs. The push of a button sends instructions to a robot arm that carves out perfectly scaled model parts. Then, they are carefully painted with acrylic, making the models, which can cost $1,000 to $10,000, almost indistinguishable from the finished product. Often only when such a precise model is ready does a critical flaw or need for a change become obvious, clients say.

Design approved, it was time for 6 months of necessary drudgery. An appealing style is one thing, but it's another to pack in components and make sure the design works practically as well as visually. Harden became the liaison for Dubbs' manufacturing engineers, and together they fine tuned the answering machine and changed dimensions slightly to accommodate the inner workings. There were changes: On the top of the machine, for example, one of the buttons is blue—a deliberate visual cue to draw the user's eye to the most essential function, "play." Engineers raided their eyebrows, as it meant adding another tool to the manufacturing process. Dubbs backed from.

The machine is being manufactured in Taiwan now. It will hit AT&T phone centers in time for Christmas and sell for $139. "I had a vision and this is absolutely the right thing for us," says Dubbs, who is so satisfied that he hired from to develop a followup product. There's one area, however, where even the creatively supercharged frogdesigners could not sway staid old AT&T: The product's name. Frog employees wanted to call it Flash. The phone company went with "AT&T digital answering system 1337."

[Business Week, Apr. 30, 1990]

A SMARTER WAY TO MANUFACTURE

(By Otis Port, Zachary Schiller, and Resa W. King)

HOW 'CURRENT ENGINEERING' CAN REINVIGORATE AMERICAN INDUSTRY

At its new plant in Atlanta, NCR Corp. is trying an approach to product development that could put U.S. manufacturing back on a par with the Japanese—by churning out better quality things faster and at lower cost. Like most manufacturers, NCT used to develop products in a series of steps, starting with design and engineering, then letting contracts for various materials, parts, and services, then finally going to production. Each step was largely independent of the others, and changes made at any postdesign stage, especially after production started, caused major traumas. The late fixes would ripple back through a project, causing everything that had gone before to be reworked. That would delay the product and push its costs through the ceiling. So NCR decided to test a new method: do everything concurrently.

CLOSE QUARTERS

In Atlanta, where NCR makes terminals for checkout counters, the company tried concurrent engineering for its latest machine. The work started in January 1987, and the product rolled out 22 months later—one-half the normal time. The terminal has 85 percent fewer parts than its predecessor and can be assembled in 2 minutes, or one-fourth the time. That convinced NCR. It tore down the wall that separates most design and manufacturing departments. Now, all the plant's 100-odd engineers are located in a pool of identical cubicles. When a project starts up, the engineers play musical cubicles, so the specialists involved in design, software, hardware, purchasing, manufacturing, and field support all work side by side and compare notes constantly. This makes for more synergy, curbs late fixes, and achieves what William R. Sprague, NCR's senior manufacturing engineer in Atlanta, calls "the overriding factor"—getting products out on time.

NCR isn't alone in switching to CE. American Telephone & Telegraph Co. latched onto the concept when it redesigned its main phone-switching computers. The total "cycle time" from conception to production was trimmed by more than one-half from the normal 3 years, and manufacturing defects plunged as much as 87 percent. Deere & Co. began using concurrent engineering in the late 1980's and has slashed the previous 7-year cycle time for construction and forestry equipment by 60 percent, saving 30 percent of the usual development costs.

These are just 2 of the 11 case studies uncovered in a survey for the Pentagon by the Institute for Defense Analysis, an Arlington, VA, researcher on defense industry issues. "The whole world is coming to the conclusion that something like this must be done," says Ramana Reddy, director of West Virginia University's 2-year-old Concurrent Engineering Research Center, which is funded by the Defense Department. By the year 2000, proponents believe, few companies will remain untouched. And that will unleash the most wrenching cultural upheaval in manufacturing in 50 years.

The potential advantages of concurrent engineering have been recognized for decades. But earlier calls for it were thwarted by middle-management fiefdoms and by the lack of computerized tools to spur cooperation between departments. Now that such tools are emerging, top management is cracking down and forcing design and manufacturing, in particular, to collaborate. More and more senior executives realize that U.S. industry's problem isn't coming up with novel designs, it's getting products out the door. In the 1980's, the hoped-fore antidote was billions spent on automating factories, where 85 percent of a product's costs are incurred. "But we got it backward," says Aris Melissaratos, general manager of engineering and manufacturing operations for Westinghouse Electric Corp.'s Electronic Systems Group.

It turns out that no amount of factory automation can compensate for a poor design. That's because up to 90 percent of production costs are preordained by design decisions made long before the blueprint reaches the shop floor. Left uncorrected, overly complicated designs can cause devastating delays. In the fast-track electronics sector, the accepted rule of thumb is that the first two manufacturers that get a new-generation product to market lock up as much as 80 percent of the business. And it's crazy to risk losing that edge. McKinsey & Co. calculates that going 50 percent over budget during development to get a product out on time reduces its total profits by only 4 percent. But staying on budget and getting to market 6 months late reduces profits by one-third. "You can't afford to miss the window," says NCR's

Sprague. With so much at stake, nothing is likely to head off CE. Not even middle managers with empires to protect.

FORGOTTEN IDEA

The roots of all this trace back a decade, to when Japanese companies stunned their U.S. rivals by spewing out products of ever higher quality at lower and lower prices. Even more shocking were the reports of study groups just back from Japan: Production lines often operated at quality levels 1,000 percent better than the best comparable factories in the United States. This stemmed largely from the fact that the Japanese—emulating the way American companies operated prior to World War II—don't have separate design and manufacturing functions. Their product engineers are equally adept at both. And they tend to engineer quality into the manufacturing process, while the United States relies on assembly line inspections to weed out defects.

Alarmed, the leading U.S. electronics companies decided they had to make quantum jumps in quality and cycle times. What they discovered is that "all roads lead to a few keys to competitiveness," says Terrance R. Ozan, director of manufacturing consulting services at Ernst & Young. "If you cut through the buzzwords, the strategic issue are time to market and quality, plus flexibility in responding to changing customer needs and market forces—and then cost."

But it's a lot easier to recognize this than to get companies to change a style that has become ingrained over the past 50 years. The present method of product development is like a relay race. The research and marketing department comes up with a product idea and hands it off to design. Design engineers craft a blueprint and a handbuilt prototype. Then, they throw the design "over the wall" to manufacturing, where production engineers struggle to devise a way to bring the blueprint to life. Often this proves so daunting that the blueprint has to be kicked back for revision, and the relay must be run again—and this can happen over and over. Once everything seems set, the purchasing department calls for bids on the necessary materials, parts, and factory equipment—stuff that can take months or even years to get. Worst of all, a design glitch may turn up after all these wheels are in motion. Then, everything grinds to a halt until yet another so-called engineering change order is made.

Apart from wasting time, this approach fosters bureaucracy. Layers of jobs sprout up around each departmental function, and the turf gets carefully marked out. William D. Christ, a senior consultant at United Research Co. in Morristown, NJ, recalls seeing this in 185 at RCA Corp.'s Consumer Electronics Division, which has since been acquired by Thomson-CSF of France. United Research consultants were there to help speed up development of a new TV set. But Christ recalls how an RCA design-manager professed to hate dealing with manufacturing engineers because they invariably complained that if the designers would just get it right the first time, there would not be so many costly changes. Besides, added the designer, his group was hardly to blame if manufacturing could not make what the designers proposed.

At companies that are converting to CE, there's no room anymore for such talk. At Westinghouse's Electronic Systems Group, for instance, both design and manufacturing have been put under one manager, Melissaratos. "I'm the embodiment of concurrent engineering," he says. To help foster teamwork among both groups of engineers, he has set up shop-floor laboratories. Outfitted with the same equipment that will be used for production, the labs are a meeting ground where CE teams prove out their designs.

That's just a preview of the changes in store throughout U.S. manufacturing. At General Electric Co.'s appliance division, for example, up to 21 managers once had to sign off on designs and changes. Now, only a few do. At Motorola Inc.'s radio-telephone plant in Schaumburg, IL, the management hierarchy has been trimmed from seven tiers to no more than four. At Eastman Kodak Co., which is restructuring for CE, too, cross-functional teams are working together more smoothly and mediating their own disputes in a fraction of the time that it once took.

"Instead of passing information from one level to the other, with management approval at each step, we now have teams that communicate electronically and make decisions themselves," says Elmer R. Noxon, director of Kodak's engineering systems division. "It eliminates the organizational approval process." Adds David G. Hewitt, senior vice president of manufacturing technology at United Research: "The really significant change comes from unleashing a company's creative forces, which had been frustrated by 'me think, you do' hierarchies."

BRAINSTORMING

The transformation isn't stopping at the door. Since every major product made in the United States contains purchased parts, concurrent engineering must also encompass suppliers, notes H. Barry Bebb, a vice president at Xerox Corp. He adds that outside parts account for over one-half the value added to Xerox's copy machines. In such cases, suppliers must be brought in on day one, to get the same head start as the rest of the product development team.

"Having the right relationship with your vendors is absolutely fundamental," says Edward J. Kfoury, president of IBM's Industrial Sector Division. "If you hold your vendor to the same standards (of quality, timeliness, and manufacturability), and provide him with the same tools, then it doesn't matter whether you do it or the vendor does it. It becomes an economic decision"—who can do it best.

Using concurrent engineering to harness the ingenuity of America's small manufacturers could spark an industrial renaissance. Small- and medium-size companies are the backbone of U.S. industry. Every big manufacturer depends on them. Yet most smaller companies lag a decade behind in adopting new manufacturing technology. To help bring them up to speed, the National Institute of Standards & Technology has mounted a campaign patterned after the Agriculture Department's extension service. Combined with the missionary work of bigger companies, the result could be a massive technology-transfer program. And that would provide American industry with new sources of rich expertise, improving its ability to respond quickly to market shifts.

The Japanese already know this. Customarily, they go to great lengths to help suppliers strengthen their businesses—even though the supplier may then sell to a rival producer. Ricoh Co., a leading builder of facsimile machines, actually put Azon Corp., America's top producer of blueprint paper, into the fax-paper business. First Ricoh licensed its technology to the privately held Johnson City, NY, company. Then, it trained Azon's engineers in Japan. Azon cranked up production last autumn, not as Ricoh's captive supplier but as an independent producer. Normally, even Japanese companies don't go that far. But Ricoh could not find an American papermaker that measured up to its standards for quality and productivity, and Keiji Endoh, chairman of its New Jersey-based U.S. operation, felt it important to domestically source more of the products Ricoh sells in the United States.

That doesn't mean Ricoh will tolerate shoddy work, as Azon President William L. Bordages found out. Though Azon has sold blueprint paper in Japan for 40 years, Bordages was stunned by Ricoh's demands. It sent teams to audit Azon's production methods and quality assurance procedures—plus its management practices and finances. "We had to tell them things we don't even tell our mothers," says Bordages.

But in the end, he adds, the exercise proved worthwhile. "We learned as much from the paces they put us through—about how to make this a better company—as they did about us." Most U.S. companies that supply Japanese outposts in the United States tell the same story. At first, the Japanese seem "unreasonable, inflexible, and relentless," says one American executive. Then, it gradually becomes clear that they are laying the foundation for a long-term relationship that will benefit both parties. Ultimately, the U.S. suppliers wonder why their U.S. customers are so lax.

SHAPE UP

Now, some are wising up. Motorola believes that suppliers should participate in concurrent engineering projects—but only if they can match Motorola's internal standards for quality. So the word went out from former Chairman Robert W. Galvin: shape up by 1995, or kiss off future business with Motorola. To help suppliers meet its goals, Motorola sends its engineers on inspection visits to audit their progress on quality and help them over humps. Motorola doesn't overlook anyone, not even tiny Custom Rubber Co., a $2 million producer of rubber parts in Cleveland. Owner William H. Braun says Motorola engineers helped him set up a quality assurance system, and they continue to monitor it. They don't just want zero defects, says Braun, "they want to know why there are no defects."

The latest computerized tools are making concurrent engineering much easier. Computer-aided design (CAD) systems now capture, in three-dimensional models, all the information needed by such "downstream" functions as purchasing and manufacturing. Ongoing efforts to standardize CAD data mean that it's possible to work on the same model with the various brands of CAD and computer-aided engineering systems owned by a company and its suppliers. And new electronic data-management systems assure that all team players use the latest version of the design, not one that was updated hours or days earlier by another department. So, unlike a few

years ago, it is now feasible to do concurrent engineering on a global scale, linking hundreds of engineers around the world.

One such extended family was honored last October with the Society of Manufacturing Engineers' annual award for excellence in computer-integrated manufacturing. Digital Equipment Corp.'s Storage & Information Management Group collected the prize for the network that produces its new hard-disk drive. Design is coordinated from the group's Colorado Springs headquarters for final assembly that takes place in two clean rooms, one in Colorado Springs, the other in Kaufbeuren, West Germany. Components arrive at the two sites from DEC plants in Arizona, Massachusetts, and Puerto Rico. And the parts for those come from suppliers as far off as China. "Concurrent engineering had to be part of the program," says Charlotte Frederick, product technology manager at the storage unit. Given the cost of the two clean rooms—$50 million each—"we couldn't afford to develop products that weren't manufacturable."

TOOL KIT

Improved computer systems may even bring CE to the biggest customer of all, the Pentagon. It has been working since the mid-1980's to convert its mountain of paper into compact digital information. Michael F. McGrath, director of the Pentagon's billion dollar Computer-aided Acquisitions Logistic Support (CALS) program, notes that the cruiser *Vincennes* would ride 3½ inches higher if it could jettison the 23 tons of paper documents relating to the care of the various systems. But CE is what he's really after. Already, new proposals and engineering designs must be submitted to the Defense Department on computer tape or disks. "What CALS is bringing to the table," says McGrath, "is the set of tools that lets you achieve the potential of concurrent engineering."

Indeed, our Pentagon gave CALS the green light, Lt. Gen. John M. "Mike Loh, commander of the Aeronautical Systems Division (ASD), at Wright-Patterson Air Force Base, figured it was time for the next step. "We've got to raise the stature of the manufacturing and field-support communities to the level of design engineers, who until now have been calling the shots." To get that message across, ASD plans to "disestablish its existing organization," says John C. Halpin, Loh's deputy on engineering and quality matters. The division's 1,700 design and systems engineers will be merged with several hundred manufacturing and maintenance engineers now in other Air Force units. "ASD will lead by example, not just go out and try to jawbone the contractors into adopting CE," Halpin says.

Halpin thinks that could take 7 to 10 years. That dovetails with the experience of the CE pioneers. Even in small companies, recasting the corporate culture takes 5 years or more. But it has to be done, says Loh, because American industry is "going to be in even deeper trouble in the 1990's" if it doesn't act soon—and keep acting. "This is a never-ending journey," says IBM's Kfoury. "You must never get to the point where you're satisfied." Since 1985, IBM has cut its cycle time for large systems in half, to less than 3 years. Yet Big Blue is far from content. The new 5-year goal, set by Chairman John F. Akers, is to be far better still.

Certainly, the overriding lesson learned from the push to concurrent engineering is that America's shortcomings in producing high-quality products inexpensively and getting them to market on time are largely the result of self-fulfilling prophecies. Until now, companies have assumed that since it seemed unlikely that functions as different as design and manufacturing could work together, they should do their jobs separately. And expecting things to get done right the first time, whether in design or manufacturing, seemed too absurd to be realistic. As trivial as it may sound, the remedy turns out to be really simple: aim higher.

Senator KERRY. Just a few quick questions, if I can.

Mr. Ginn, I was left hanging at the vote on a question I asked, and I wondered what your reaction would be with respect to a bar or safeguard on joint ventures with foreign firms when their home market countries are closed to U.S. firms.

Mr. GINN. Well, I think it is a matter of balance that this committee has to think about. But I think you ought to understand that every time you put a constraint on us, you take away from the objectives, the goals of this legislation. You know, if you say we cannot joint venture with another RBOC, then you lessen our ability to do things we could otherwise do. And so, if you say that we cannot joint venture with someone from a country that does not

allow our telecommunications equipment to be imported, to me that is trade policy of the United States. I would hope you would not do that.

I would want you to understand that if you did it, you are lessening our capability to serve customers.

Senator KERRY. Do you want to comment on that?

Mr. KILPATRIC. No.

Senator KERRY. Again, I want to ask both of you some questions, but you said one of the main reasons, or one of the most important reasons that has been put forward for allowing the Bells into the manufacturing is that they can provide capital to smaller companies, and the capital market would be enhanced.

But the U.S. capital market is generally assumed to be one of the most efficient in the world. And I wonder why you think that you would be able to judge the potential of the small company in a way that the capital market would not be capable of doing right now.

Mr. GINN. Because we bring more than capital, because we bring more than capital. Let me give an example. We are running out of spectrum in Los Angeles on cellular. There are a number of companies that have new technologies that give us four times the capacity. But they are small, they are entrepreneurial, they are undercapitalized.

So it, when we come together, we bring what we bring to that partnership, all of our knowledge about cellular, about customer demand, about how the network operates. And we bring capital as well, and they bring their innovative technology. It is a synergistic thing that has a chance to work many, many times.

Matter of fact, my own view of what will happen is that you will see far fewer big companies and big companies getting together in joint ventures. How I see the world evolving is a company like ours, we will bring market knowledge, market know-how, some technical capability, and we will be looking for people who have entrepreneurial special knowledges where we can combine our capabilities to serve a market need.

So, what I am going to predict, if this bill passes, is you will see big companies working with many, many small companies. And I think that is what you want. I think that is the objective of the legislation.

Senator KERRY. Now those other things that you bring to that joint venture that you cited are the product of the sort of monopoly status. And are inevitably, are they not, subsidized by the rate regulatory process?

Mr. GINN. Well, in the case I just mentioned to you, no. Cellular——

Senator KERRY. Engineers would not be? Would engineers not be designing conceivably——

Mr. GINN. No. No, no. Pactel Cellular is an entirely separate corporate entity in a competitive market as AT&T is in a competitive market. That example happened not to be in the Bell-regulated telephone company.

Senator KERRY. What, just a last question, again, for you, that, give me a sense of the market needs that you do not think have really been developed, that are sort of crying out for development beyond the spectrum that you talked about. Where do you see the

market demanding somehow something that is not being met at this time?

Mr. GINN. Let me talk in conceptual terms, because I think this is a very important point. What I see happening in our industry is markets are segmenting in finer and finer grain.

Now, if you look back, think about ATM's and what a revolution that has made in our society. Well, that was a synergistic process of the banking industry working with the telecommunications industry in coming up with that product. And it met a very specific, very specific customer need.

Now, I say that is how we are going to get productivity in the future. And there are going to be thousands of opportunities in major industries across the country, education, financial services, whatever, where specific products and services get designed to help them do their work more efficiently.

I was talking to a Pacific Bell salesperson a few months ago. She, they come from all over. She said, "I was just talking with a fishing fleet that works out of San Francisco. And what they would like to do is they get their, they make their catch and they are looking for a way to get that catch back into the system so the restaurants can purchase the fish before they get back to port."

Well, I would, I mean, I would never understand that as need, but when you are working in an industry, you are working with customers, there are many, many ways that you innovate, that you create, to help solve business problems. And what this bill would do, I think, is allow the Bell operating companies to be real players in that game.

Senator KERRY. Picking up on that, Mr. Kilpatric, the manufacturing portion of this is what has concerned me far more than, for instance, the design and development portion. And, in fact, Mr. Ginn and I met recently and we were talking about some of that. And I accept the concept that there really are some inefficiencies in the current system that they are laboring with.

And the judge has interpreted manufacturing in a way that includes design and development and so forth. Does that not really cut the Bells off currently from product development, and therefore create the inefficiencies that are being talked about?

Mr. KILPATRIC. Not nearly as much as I sometimes read. I believe that there is a great deal more freedom than the Bells are now exercising in doing the basic research in development that they are permitted to do, in creating the working relationship with large and small manufacturers presently in the market.

My own company has conversations from time to time with one or more of the Bell companies who want something customized for their use. The technology is there to do it. There is no question about the deposit of technology that the company, the country has. It is getting it implemented in the marketplace, and the biggest impediment to that is a reservation that I perceive on the part of the Bell companies to go ahead and make a commitment so that manufacturers can expend the funds and sell to them.

And I simply believe that as long as the 7 Bells continue to have a monopoly exchange service, it is not possible for them to be one of 7,000 providers of telecommunications equipment. They will absorb all or nearly all or a very substantial portion of the others.

So, it seems to me that so long as that local monopoly exists, there really is a choice to be made. And the problem is that——

Senator KERRY. Well, do the safeguards that are created in here in terms of who they can sell to and how and where, and the separateness of the capitalization and so forth, not protect against that kind of absorption?

Mr. KILPATRIC. Every safeguard that I have read that is in this legislation existed in the predivestiture period. I was practicing in this industry for 14 years before divestiture. I have never heard a state or federal regulator currently having the responsibility for regulation of manufacturing ever say they had the wherewithal to accomplish the task. To the contrary, they always say the opposite.

The problem with an introduction now of manufacturing by the Bells is that we would inevitably have another round of this intense dislocation that has occurred that has produced such things as plant closings and downsizings.

And we would never have, as we might now, indeed I think we clearly will, with the separation, a rising of new technologies and new applications that will, over the course of time, probably the decade of the 1990's, allow us not only to reclaim those jobs but to go far behind.

Mr. GINN. I want to respond to that. I think telecommunications information technology is the industry of the 1990's. This business about putting other people out of business I cannot, I do not see that. What I see is expanding markets. Seven companies out of 7,000, in my opinion, are, to the extent that they participate, are going to help, not hurt. They are going to add to the creativity. They are going to add to the innovation.

And we had better, because the infrastructure that we put in place in this country——

Senator KERRY. I am sure they will add to the market, but these are not just seven companies. These are seven very big companies, with enormous capital available to them.

Mr. GINN. Yeah, and seven companies that——

Senator KERRY. Why would the absorption not take place then? Why would the efficiencies of the marketplace for that kind of capital available not just wind up with acquisition, acquisition absorption?

Mr. GINN. Well, because we do not have unlimited capital.

Senator KERRY. It is not unlimited, but, I understand that.

Mr. GINN. As a matter of fact, we spend a lot of time prioritizing our capital, and capital gets allocated basically on how it can, how, what kind of return you can earn on it. And if you cannot earn decent returns, then we would not be allocating capital just to acquire other manufacturing companies. Not interested in that, do not want to do it. My shareowners may have other ideas about who ought to be the CEO if I did.

Senator KERRY. Well, I have gone on longer than I meant to, Mr. Chairman. I would like to just have the followup of some questions, if I can, for the record. But I appreciate the distinctions you drew.

The CHAIRMAN [presiding]. Very good.

Senator Exon.

Senator EXON. Mr. Chairman, thank you very much. Mr. Ginn, you are speaking for not only your organization, but the RBOC's here today, is that correct?

Mr. GINN. Yes, sir.

Senator EXON. Let me ask the question in this manner. You take it, from what I am hearing in listening to you, and disputed by Mr. Kilpatric, that you feel that, rather than hurting AT&T, the additional competition that the Bells would provide would be good for the overall industry, including you and AT&T. Is that correct?

Mr. GINN. Yes, sir. I think the market is going to become more robust, not less.

Senator EXON. What is your response to that, Mr. Kilpatric? I cannot imagine that AT&T, as big and with the experience that your organization has, with some of the most fabulous laboratories and technicians in the world, would be concerned about that upstart competition, that at one time bought almost everything that you made.

Mr. KILPATRIC. Senator, we would be happy to face any competition in a situation where we could get information about the local network's technical standards early enough to know, if we could be sure that our price would not have to compete against a subsidized price.

Take the example that Senator Danforth was using earlier today, a joint venture between Southwestern Bell, as he put it, and Siemens. If there were such a relationship, the opportunities for Siemens employees and Southwestern Bell employees to be together would be uncountable. That is the very reason they got together.

In those conversations, information would be passed about network plans, 2 years, 5 years down the road. It is inevitable that that kind of information would go back and forth. How would General Rill or a regulator know about that in time to protect the competitive process? I am not worried about AT&T here, but the process itself.

It is considerations like that that make us concerned, not about facing Sam or any of his fellow CEO's, if we could do it on the merits, when they do not have a monopoly local exchange.

Senator EXON. So, you are back to the basic situation, that you believe that regardless of the barriers put up, that the Bells would indeed be using their revenue from their operating companies to provide unfair competition against AT&T. Is that what you are saying?

Mr. KILPATRIC. Senator, they are honorable men, but the opportunities and the incentives to do so would be present, and the experience with regulation certainly did not work.

Senator EXON. Do you, Mr. Ginn, feel that the language in the bill to try and protect American jobs, although opposed by the administration, is a workable proposition? And do you believe that you can say in full conviction here today that the Bells would be in a position to abide by those rules and regulations as outlined? And if not, do you think that the rules are written strong enough so indeed the Justice Department might be able to move in, and if you do not treat others unfairly?

Mr. GINN. Well, let me answer——

Senator EXON. If you do treat others unfairly.

Mr. GINN. Let me answer the easy one first. Whatever the rules are, we will obey them. I found it fairly interesting in the last panel. You essentially had before you the key people that regulate us. You did not have the State regulators here who play a very active day-to-day, detailed role.

And every one of those regulators and policy people said, "We do not believe it is a problem. We do not believe it is a problem, and we think we can do our job. We think we can do our job on cross-subsidy."

As a matter of fact, as I think I remember their testimony, some of them said, "We do not even need all the provisions, these self-dealing provisions that you have got."

Senator EXON. Because we have got the antitrust laws.

Mr. GINN. You have got the antitrust. We watch them all the time; we think we do a good job, and we do not think we need these embedded in legislation. And I must say that I do worry that once they get embedded in legislation, then it is going to be pretty hard to get your attention on this matter for a very long time again.

And so I, if I had my druthers, I suppose I would support putting more authority in the hands of the FCC. But we have said we support this bill, and we support it with its current provisions. There are some issues that if we had written it, we would have written it differently. But as I opened with, as my opening statement, we support the bill, the seven regional companies support the bill.

Senator EXON. Mr. Kilpatric, getting back to this job situation, how many, how many jobs has AT&T shipped out of the United States in the last 10 years, manufacturingwise?

Mr. KILPATRIC. Senator, I cannot give the figure here, but I will provide it.

Senator EXON. It has been a number, has it not?

Mr. KILPATRIC. The number of jobs that have gone overseas to replace jobs previously performed in the United States are not as large as the questions here would seem to suggest. But I cannot quantify it. I will do so.

Senator EXON. Well, I think that is very key to the situation. You know, I think we are struggling to be fair to everyone up here——

Mr. KILPATRIC. I understand.

Senator EXON [continuing]. And, you know, whether the administration likes the job content, the protection features of all this or not. That does not bother me. I do not care what they think of that. They also want to open up a free trade zone with Mexico, and you were here earlier, you heard what I said and felt about that.

America is going to have to wake up some time, and if we can keep making it easier for AT&T or any other company to send jobs overseas, it is going to come home to haunt us. It is going to start a standard of living decline in America. And I am confident that the free trade zone with Mexico, what if there was a disaster we talked about earlier for America? I think that would be it.

But, in any event, I am very much concerned about the old cheap labor business and the effect it has on our people.

Mr. KILPATRIC. Senator, I am not a fortune teller, certainly, and I am not a technologist. But it does seem to me that in those instances where jobs have been put outside the United States in

order to remain cost-competitive in highly competitive low-end jobs, it is entirely possible that that level of technology at some point, certainly in the decade, could be subsumed in higher level technology if we could ever be clear how we are going to have a supply for the network go forward.

So, a lot of this is not a consequence of divestiture. For example, it was the FCC long before divestiture that allowed the connection of plain old telephones to the network. That meant that folks did not keep them in good repair anymore and they wanted a very low price. And that kind of thing simply could not be manufactured here. But that may not be the circumstance forever, given what is happening with technology.

In those instances where we have placed jobs overseas in order to open up a foreign market to our manufacturing, that is not a displacement of jobs here. We were not selling there before. And so we are hiring low——

Senator EXON. Yes, but you and many other companies, you know, let us—you and many other companies are opening plants overseas and making it and shipping it back in here and having it used by the RBOC's and everyone else. It is not just you. Is it not a very popular thing to do today?

Mr. KILPATRIC. It is popular in those markets that were so competitive we could not have remained in them if we had been manufacturing here, the ones that I have described and they have been made part of the record——

Senator EXON. And when you talk about being competitive, you are talking about wage rates, are you not?

Mr. KILPATRIC. That is certainly an element.

Senator EXON. Well, I am going to cite here a story very briefly that this committee has heard before, but I have heard 3 or 4 years ago, and Senator Hollings was along. We attended a Pacific Rim meeting, and we went to a plant in Hong Kong. And when we got through, we said:

> How do your wage rates compare with here and those of your plants in the United States? We only have one plant left in the United States, but in our plants over here, compare apples and apples, $9.50 an hour at our one plant left in the United States, $1.50 an hour here in Hong Kong, $1.50 in, for most, $1.50 in South Korea. But in our brand new plant in Shanghai, China, where we use a lot of robots, it is 25 cents an hour.

Now, sooner or later, the people of America are going to have to understand that we cannot continue, in my view, to ship all of our jobs overseas for cheap labor, and still go on and enjoy the standard of living that we have here in America. And that is a major concern of mine and it is a major reason that I will, find I will make my determination one way or the other on this particular bill.

Gentlemen, thank you very much.

Thank you, Mr. Chairman.

Senator INOUYE [presiding]. I have just one question. If this bill becomes the law of the land, most assume that its impact will be positive and profitable on the Bell operating companies. What will be the impact on the operations on AT&T?

Mr. KILPATRIC. That is hard to say because of the possibilities of technological advancements and the economies that we would hope

to put into our manufacturing plants. But obviously we have to have a level of revenues in order to sustain research. I believe the figure right now is approximately 50 percent of the Bell Labs' budget comes from sales to the operating telephone companies.

So, my hope would be that the experience, if it occurs, would be no worse than we have just gone through, where there might be some dips in some product lines. But with sufficient revenues we could have technologies and economies that would bring it back.

But the range of manufacturing activity for RBOC's, which the legislation would permit, is so all-encompassing, it is hard to see if they were to avail themselves of the legislation to its maximum, why there would not be a very substantial negative impact on the whole industry, including AT&T.

Senator INOUYE. I would like to announce at this time that the record will be kept open for 2 weeks, and witnesses, if they wish to submit addendums or corrections or amendments, may feel free to do so. Thank you very much, gentlemen.

Mr. KILPATRIC. Thank you, sir.

Senator INOUYE. And now our final panel, consisting of the executive vice president of the Communication Workers of America, Ms. Barbara J. Easterling; the general counsel of the Telecommunications Industry Association of Washington, Mr. Paul Vishny; the president of Concept Communications of Dallas, TX, Mr. Stuart Gibson; the president of Morse Security Group of Silmar, CA, Mr. Michael S. Weinstock; and the president of National Association of State Utility Consumer Advocates of Washington, Mr. Ronald J. Binz.

Ms. Easterling and gentlemen, I thank you for the patience you have demonstrated all afternoon. May we assure you that, although the hour is late, your testimony will be very seriously considered by all members of the committee. The issue before us is an important one, and we will treat your testimony in that light.

May I first call upon Ms. Easterling?

STATEMENT OF BARBARA J. EASTERLING, EXECUTIVE VICE PRESIDENT, COMMUNICATIONS WORKERS OF AMERICA

Ms. EASTERLING. Thank you. On behalf of the Communications Workers of America, I am pleased to appear here to support S. 173, which would allow the Bell operating companies to manufacture equipment domestically. I would like to publicly thank Chairman Hollings and his staff for helping to move the legislation along by actively encouraging our union and the Bell operating companies to meet to resolve our mutual problems with the bill.

Ever since the Bell operating company manufacturing issue arose several years ago, CWA's position has consistently been that the processes must be conducted domestically. We in this Nation have seen far too many jobs exported in far too many industries, including telecommunications, and we are very pleased that the BOC's have the courage to take a position that can only increase jobs here in America.

In general, the bill runs in the same direction as H.R. 452, introduced in January by Representative John Bryant of Texas, because both bills create a positive incentive to the Bell companies to conduct their manufacturing in the United States. We construe the

legislation as including bans on mere "screwdriver" manufacturing. And we hope to discourage technological transfer and maquiladora-style operations in Mexico, which have proven to be so popular among the Fortune 500, including AT&T.

A few arguments against the domestic manufacturing requirement have surfaced. But you need only look at an AT&T circuit board, which I have here today, to see why domestic content must remain in the bill. A complete breakdown of its components, including the box it was shipped in, will reveal 80 percent foreign content. With the naked eye, one can see more than 60 chips stamped Taiwan or Japan. None of them is stamped, "Made in the U.S.A."

This is contrary to AT&T's testimony last year that 90 percent of what it sells to any customer in the United States is manufactured here. In my written statement, our numbers from the Bureau of Labor Statistics showing the severe decline in U.S. telecommunications nonsupervisory manufacturing jobs from 1981 to mid-1990, 104,800 jobs are now down to 58,700 jobs, about a 50-percent loss.

And gentlemen, these are human beings. They are families that we are talking about. Unfortunately, we do not often equate numbers and statistics to faces, many of whom may be among America's homeless. It has been too easily overlooked that the divestiture of the American Telephone & Telegraph Co. still affects people, as well as corporations, money, rate schedules, stock certificates, and telephone equipment.

It is those people who are CWA's only product, and the reason we are here today. It is also the reason CWA believes that legislation to provide rehire rights for ex-Bell System workers should be included in any measure to restructure national telecommunications policy. CWA feels that this bill will create opportunities for AT&T, since the RBOC's must try to find an American manufacturer before going overseas. AT&T can be that manufacturer. 701.002

Mr. Chairman, let me conclude by again commending Senator Hollings and the cosponsors' position to stand up and to be counted with America's workers, with CWA and the BOC's, in essence to say enough is enough, by keeping American manufacturing jobs in America, and telephone equipment emblazoned with the label, "Made in the U.S.A."

Thank you.

[The prepared statement of Ms. Easterling follows:]

PREPARED STATEMENT OF BARBARA J. EASTERLING

On behalf of the Communications Workers of America (CWA), I am pleased to appear here to discuss your bill, S. 173, which would allow the Bell Operating Companies (BOCs) to manufacture equipment in the United States. Your bill would lift some restrictions imposed by the 1982 consent decree by which the old Bell System was broken up.

Let me publicly thank Chairman Hollings and his staff for helping to move this legislation along, by actively encouraging our union and the BOCs to meet to resolve our mutual problems with the earlier bill, S. 1981, as reported last May.

During the late summer of 1990, CWA and BOC representatives worked together to resolve those major problems. We and the BOCs all were quite uncomfortable with the "waiver provisions" of the bill, which called on the FGG to make rulings on equipment manufacture matters. We and the BOCs fashioned new language to resolve our problems with the 1990 bill's language.

Our agreed-on intent was to enhance telecommunications equipment manufacturing in the United States. We recognized that some needed items may not be avail-

able in the domestic market and that therefore a realistic approach would lead away from an "absolutist" set of rules banning any foreign content.

Ever since the BOC manufacturing issue arose several years ago, CWA's position has been that the processes must be conducted domestically. We in this nation have seen far too many jobs exported in far too many industries, now including telecommunications. And we are very pleased that the BOCs have the courage to take a position that can only increase jobs here in America.

S. 173 provides for a domestic manufacturing process. In addition, the bill defines the term "manufacture," as originally set out by District Judge Harold H. Greene in December 1987, and later affirmed by the U.S. Circuit Court of Appeals.

In preparing for this hearing, we have become aware that some of the equipment supplier trade organizations have prepared materials to point to the existence of sizable "loopholes" in the domestic content and other features of this legislation. CWA is grateful that these concerns have been brought forward. While we believe the alleged defects in the legislation may be overdrawn, we certainly urge the committee to examine the competitors' concerns and provide sufficient clarification to ensure that the intent of CWA and the BOCs, as we agreed last summer, will be carried forward in the statutory language and legislative history of S. 173.

We observe that in general your bill runs in the same direction as H.R. 452, introduced in January by Rep. John Bryant of Texas. That legislation also creates a positive incentive to the Bell and other telephone companies to conduct their manufacturing in the United States. We interpret your legislation as explicitly including bans on mere "screwdriver" manufacturing. We hope to discourage further technology transfer and "maquiladora"-style operations in Mexico, which have proven so popular among the Fortune 500.

We now are hearing some rather weak arguments against the domestic manufacturing requirement; allegedly it would violate some fuzzy trade agreement concepts. The position of the Congress should be simply that the grant of authority to manufacture will carry certain responsibilities as necessary conditions. Domestic operations are as germane in this context as are requirements to avoid cross-subsidy and predatory pricing and to continue "open" procurement of equipment. The AT&T divestiture was unwisely fashioned, since it fully opened the United States market without the necessary trade agreements to secure full "cash-register-ringing" access to foreign markets.

We are keenly aware that some interests are either openly opposed or will waffle when asked about domestic manufacturing and fabrication; some will merely state the empty words that they "would prefer" to see manufacturing within our nation. Some will term a domestic-manufacture requirement "counterproductive" without any logic or reason for that contention.

We know that a sizable imbalance in the telecommunications equipment trade exists, with the latest reliable numbers those for 1988—$3.3 billion in exports vs. $5.8 billion in imports. We have attempted to make sense of the 1989 figures reported by the Department of Commerce, but have found that the counting system has been radically changed.

What is very clear is that imported equipment means employment in other nations on equipment that very well could and should be made here. The Congress needs to keep in mind whether sound public policy includes encouragement of further dollar outflow due to telecommunications equipment purchases from overseas. We believe that if a company wants to sell the equipment in the United States, it should be made here. This policy simply mirrors that of Japan, Korea, and the European Community and others, the several so-called open-procurement agreements notwithstanding.

We have secured some "hard" numbers from the Bureau of Labor Statistics to show the decline in United States manufacturing non-supervisory employment of the SIC 3661 telecommunications equipment. For 1981, the jobs averaged 104,800. Three years later, the number had declined to 93,700. At the end of 1987, the total was 68,200. And the latest reliable number we have secured is 58,700 in May 1990. That equates to nearly a 50% loss. Since BLS has changed its counting and reporting system, we are hesitant to cite numbers from later months. After the new counting system has settled down, we hope to reconcile the old and new counting methods.

CWA firmly believes that legislation to provide rehire rights for ex-Bell System workers should be included in any legislative measure to restructure national telecommunications policy.

It has been too easily overlooked that the divestiture of the American Telephone and Telegraph Company (AT&T) still affects people as well as corporations, money, rate schedules, stock certificates and telephone equipment.

CWA looks forward to working with the committee on this legislation, including improvements and clarifications found necessary.

CWA has two major areas of interest in MFJ proceedings, both interrelated: information services and telephone company entry into cable TV. The Union supports letting the Bell companies provide information services, to help the industry accelerate its development. We supported the 101st Congress cable-telco legislation, H.R. 2437 and Sen. Gore's bill, S. 1068. We favor legislation on information services, if the current district court remand proceedings do not yield progress in that area. We believe the telephone companies can be effective service providers.

Senator INOUYE. Thank you very much, Ms. Easterling.

And now may I call upon Mr. Vishny?

STATEMENT OF PAUL VISHNY, GENERAL COUNSEL, TELECOMMUNICATIONS INDUSTRY ASSOCIATION

Mr. VISHNY. Mr. Chairman and members of the subcommittee, my name is Paul Vishny, and I am a lawyer practicing in Chicago. I am general counsel of the Telecommunications Industry Association, which is an association of over 500 manufacturers and suppliers of telecommunications equipment.

As you know, our chairman, Mike Birck, was scheduled to testify on behalf of the association, but because of the schedule change he was unable to appear. I regret his absence, because he has practical, hands-on experience as the CEO of a company which began only in 1975 and now exports 25 percent of its output, employs 2,200 American workers, and sells in excess of $200 million a year in products.

I commend to you Mike's written testimony, Mr. Chairman, and request that it be made a part of the formal record.

Senator INOUYE. Without objection.

[The prepared statement of Mr. Birck follows:]

PREPARED STATEMENT OF MR. MICHAEL J. BIRCK

My name is Michael Birck. I am the Chairman of the Telecommunications Industry Association, a national trade association whose membership includes over 500 manufacturers and suppliers of all types of telecommunications equipment and related products. TIA's members are located throughout the United States, and collectively provide the bulk of the physical plant and associated products and services used to support and improve the U.S. telecommunications network. In addition, TIA members are involved on an ever-increasing basis in providing telecommunications equipment and services in other developed and developing nations around the world.

I am also President and Chief Executive Officer of Tellabs, Inc. of Lisle, Illinois, a manufacturer of high-technology telecommunications equipment for sale to local telephone companies, interexchange carriers and other telecommunications providers, as well as private users. Tellabs was founded in 1975. Today it is a public company with over 2,200 employees and annual sales for 1990 of approximately $211 million.

I appreciate the opportunity to appear before the Subcommittee to convey to you TIA's views concerning S. 173 and the public policy issues raised by this legislation, which would in effect remove the manufacturing "line of business" restriction imposed on the divested Bell Operating Companies (BOCs) under the terms of the Modification of Final Judgment (MFJ), the consent decree entered in 1982, in settlement of the government's antitrust suit against the Bell System.

TIA supports Congressional efforts to ensure that the line of business constraints contained in the MFJ remain consistent with our national interest. TIA also supports S. 173's goal of enhancing this nation's industrial competitiveness. However, while Congress has both the right and the responsibility to review and alter the current legal and regulatory framework to further the national interest, TIA continues to believe that removal or substantial modification of the MFJ manufacturing restriction would have a significant adverse impact on competition, innovation, consumer welfare, and the competitiveness of the U.S. equipment industry in domestic and foreign telecommunications markets.

BENEFICIAL IMPACT OF MFJ ON TELECOMMUNICATIONS EQUIPMENT INDUSTRY AND CONSUMERS

TIA takes strong exception to the flawed premise which underlies S. 173, i.e., the notion that the telecommunications equipment industry in the U.S. is "on the brink of disaster" and that removal of the MFJ restriction is needed in order to "rescue" the industry and make it globally competitive. In point of fact, the more competitive, dynamic industry structure which has emerged under the MFJ has greatly strengthened the domestic telecom manufacturing sector, which today includes literally thousands of firms, many of them among the world leaders in the development of advanced telecommunications products.

As the attached statistical study of the post-divestiture U.S. telecom manufacturing industry (Attachment A) vividly demonstrates, the MFJ has had an extremely beneficial impact on the domestic manufacturing sector, on consumers of telecommunications equipment and services, and on the U.S. economy as a whole. Since divestiture, equipment prices have declined—many instances dramatically—from predivestiture levels, the quality of products in all areas has been greatly enhanced, industry research and development expenditures have risen, many new competitors have entered the market, the efficiency and competitiveness of U.S. manufacturers has increased, and there has been a proliferation of new and improved telecommunications products and services.

My own company's experience since the divestiture provides a good illustration of the beneficial impact of the MFJ within the domestic telecom equipment industry. Since 1982, the year the MFJ was approved and entered by the District Court, our business has more than tripled, with annual sales revenue increasing from $57,217,000 in 1982 to $211,046,00 in 1990. Building on the progress it has achieved in developing and marketing state-of-the-art telecommunications products in the U.S., Tellabs' is now in the process of expanding its efforts to penetrate telecommunications markets outside the U.S. 1990, Tellabs international sales were over $25 million, an increase of more than 125 percent over 1989 sales.

A number of companies which did not even exist prior to divestiture have since emerged as viable competitors in U.S. equipment markets. As the attached industry study indicates, the total number of domestic telecom manufacturers increased substantially between 1985 and 1988, with the industry's 7.1 percent compound rate of growth far exceeding the economy-wide average of 1.6 percent.

The interests of American business and residential consumers of telecom equipment and related services have also been well-served under the MFJ. Price and nonprice competition (with respect to items such as warranty protection delivery schedules, and after-sales service) has been very intense. During the immediate post-divestiture period, prices for products purchased by the BOCs from Western Electric (now AT&T Technologies) declined dramatically as the BOCs began to develop alternative sources of supply. For example, prior to divestiture, one of my company's products routinely used by local telephone companies sold for just under $1300 per circuit. By 1986, the price for this product, which had been significantly improved in the interim, was approximately $650 per circuit. The more competitive marketplace which has emerged under the MFJ continues to exert enormous downward pressure on prices, forcing manufacturers to make maximum effort to control costs for existing and newly-introduced products. Digital cross-connect equipment which Tellabs introduced in 1985, at a list price of $1,800, is currently marketed at a discounted price of just under $700; a similar product which originally sold for $2,175 is now priced at just under $900. Moreover, each of these products has been significantly upgraded to provide increased functionality.

In summary, the more open, dynamic environment created by the MFJ has yielded significant growth, reduced prices, and increased innovation throughout the domestic equipment industry, producing substantial benefits to American businesses, consumers, and the U.S. economy.

IMPACT OF THE MFJ ON U.S. TRADE AND COMPETITIVENESS

The strong (and rapidly improving) performance of the domestic telecom manufacturing industry in overseas markets provides strong corroboration for the proposition advanced most recently (and eloquently) by Michael Porter in his book "The Competitive Advantage of Nations," i.e., that vigorous domestic rivalry serves to facilitate the creation and maintenance of "competitive advantage" in an industry. The emergence of a more open, intensely competitive equipment marketplace in the U.S. has forced American manufacturers to become increasingly creative and efficient in meeting the needs of their customers. As a result, U.S. manufacturers are now better able to compete both domestically and in overseas markets.

The American position in international trade in telecommunications equipment is stronger than it has been since before divestiture and continues to improve. As the attached summary of data compiled by the Commerce Department (Attachment B) demonstrates, the trade deficit for all types of communications equipment fell dramatically from a $1.9 billion deficit for 1989 to $792 million in 1990, i.e., an improvement of over $1.1 billion in one year. The 1990 figures reflect a sustantial (24.7 percent) increase in exports as compared with a much smaller (1.6 percent) increase in imports. At this rate, the United States may well enjoy an overall trade surplus in telecommunications equipment by mid-1991.

Government trade figures reveal that the bulk of the remaining telecommunication trade deficit relates to "lower end" customer premises equipment, (e.g., telephone handsets, facsimile machines, cordless phones). The rapid growth of imports in this area began well before the divestiture, following implementation by the FCC of its Part 68 equipment registration program. Significantly, while the more open, competitive marketplace fostered by the MFJ has provided opportunities to foreign, as well as domestic equipment suppliers, the U.S. continues to maintain a trade surplus in network switching and other high-technology telecommunications products.

Moreover, the trade surplus in high-technology telecom products—i.e., switches, mobile communications equipment, transmission equipment, communications satellite, fiber optics, and other sophisticated equipment—has increased substantially over the past several years. For high-end products, the U.S. achieved a trade surplus in 1990 of $2.3 billion, up from $1.1 billion in 1989.

Of particular interest, U.S. produces are becoming increasingly successful at exporting even to countries with strong indigenous industries and markets historically closed to U.S. producers. These include Germany, where U.S. exports increased 157 percent comparing 1989 and 1990; France, where U.S. exports increased 25 percent; Taiwan, where U.S. exports increased 82 percent; Japan, where U.S. exports increased 10 percent; and Canada, where U.S. exports also increased 43 percent. The growing strength of domestic manufacturers in high-tech telecom equipment markets is reflected in the Commerce Department's continually improving trade figures, which show a reduction the overall U.S. balance of trade in telecommunications equipment from $2.6 billion in 1988 to less than $.8 billion in 1990, despite continued declines in consumer and mass market product categories.

POSITIVE IMPACT OF MFJ ON INDUSTRY R&D INVESTMENT

To succeed in the highly competitive post-divestiture environment, U.S. manufacturers have had to become increasingly efficient, innovative, and quality-conscious. The MFJ has provided tremendous opportunities for growth, by creating a new industry structure in which all manufacturers are able to compete on the merits of their products for sales to the BOCs and other potential customers. These opportunities, and challenges arising from the new, more competitive industry structure bolstered by the MFJ have provided Tellabs and other U.S. manufacturers with strong incentives to improve and expand their research and development programs.

Since the MFJ was adopted, Tellabs has increased its annual R&D commitment from $3,697,000 (or 6.45 percent of total sales) in 1982 to $31,565,000 (approximately 15 percent of total sales) in 1990. Reports show that the industry's overall expenditures on R&D have also grown substantially under the MFJ, with communications company funded R&D rising from $1.6 billion in 1977 to $5.5 billion in 1987. The efficiency of the industry's aggregate R&D investment has also been enhanced in the more competitive environment fostered by the MFJ.

This increased commitment to the development of new and improved telecommunications technology clearly has paid significant dividends. From 1980 to 1988, U.S. factory shipments of telecommunications equipment increased dramatically from $36.0 billion, to $74.2 billion in 1988, despite price reductions in all major product areas.

BOC PARTICIPATION IN TECHNOLOGY DEVELOPMENT UNDER THE MFJ

The Bell Operating Companies contend that the MFJ manufacturing restriction precludes them from making a significant contribution to the evolution of more efficient and innovative telecommunications products designed to meet the increasingly complex needs of the BOCs, other carriers, and end users. Nothing could be further from the truth.

Under the MFJ, the BOCs are permitted, and indeed encouraged, to play a major role in the evolution of new telecommunications technologies, services, and equipment. Appended to my testimony is a chart (Attachment C) which depicts the broad range of technology and equipment-related activities which the BOCs may engage in under the MFJ. As the chart indicates, the manufacturing restriction in fact en-

compasses a relatively narrow range of activities i.e., in general terms, the design and/or fabrication of telecommunications equipment or CPE. Moreover, contrary to the BOCs assertions, the MFJ does not bar them from engaging in an interactive dialogue with manufacturers who are engaged in those facets of the equipment business which the BOCs are precluded from entering.

The MFJ permits the RBOCs themselves to engage in basic and applied research into new technologies which may ultimately lead to improvements in telecommunications. Individually and through Bellcore, the BOCs are actively engaged in such research. In addition, consistent with the terms of the MFJ, the BOCs are extensively involved in network and systems engineering and a broad range of software development activities. Through their procurement-related activities (e.g., establishment of generic requirements, dissemination of network-related information critical to the design of equipment for use in or connection to the BOCs' networks, product testing, quality assurance) and through their involvement in industry standard-setting initiatives, the BOCs also have an enormous impact on the evolution of new telecommunications equipment and CPE.

The significant contribution which the BOCs and Bellcore have made, and continue to make, in the area of research and development under the MFJ is frequently overlooked or given short shift by the BOCs, in their effort to build a case for removal of the MFJ manufacturing restriction. The BOCs collectively spend well over a billion dollars each year to support their own R&D activities. As the largest domestic purchases of telecommunications equipment, each of the RBOCs also provides substantial support for the R&D programs of an increasingly diverse group of small, medium and large businesses engaged in manufacturing an ever-expanding array of products designed to meet the diverse needs of the BOCs and their customers. Moreover, because they are precluded from telecommunications equipment manufacturing, the BOCs have a strong incentive when making purchasing decisions to base those decisions on the basis of cost and the quality of the product, rather than the corporate affiliation of the supplier.

The RBOCs and their supporters have further suggested that the MFJ manufacturing restriction prevents the RBOCs from communicating with manufacturers during the product design and development process to ensure that the products which emerge correspond to the BOCs' needs. TIA does not believe that the BOCs are precluded from engaging in an ongoing constructive dialogue with their suppliers. In point of fact, the level of cooperation and interaction between the BOCs and equipment manufacturers—in the establishment of network standards, in the development of generic specifications, in the technical analysis of products which have been or may be purchased by the BOCs, and in addressing equipment compatibility problems as they arise—has increased substantially under the MFJ.

Indeed, one of the principal benefits of the MFJ has been to create art atmosphere in which the Bell Operating Companies have established a more open, cooperative relationship with the entire equipment manufacturing community. As the Vie-President of Technology Systems for Bellcore has observed, describing the progress achieved by the industry since divestiture:

Not only have we solved the immediate problems of divestiture, but we have, as an industry, moved well beyond our immediate post-divestiture circumstances. In particular, we have seen major progress towards the opening of the telecommunications marketplace through a free flow of information on architectures, requirements, and interfaces. The response has been an outpouring of products that Bellcore's clients are using to grow and evolve their networks, to provide existing services more economically than heretofore and to provide new services * * *.

In January 1984, our supplier database contained 2000 companies; by January 1986, that number had grown to 4850, and now [in 1989] we have 9000 suppliers in our database and 500 shelf feet of supplier information in our library * * *

The two-way communications that has been established between Bellcore and the telecommunications supplier community is one of the successes of divestiture.

This new relationship has broadened and deepened over time, as the BOCs have become attuned to the benefits of working with a number of vendors to better define their needs and to facilitate the development of products which meet those needs. For example, a February 19, 1990 article in Communications Week described Bellcore's active participation in the removal of "one of the biggest stumbling blocks in deploying intelligence in the public network"—i.e., the development of a viable means of connecting two vendors' central office switches to facilitate the transmission of ISDN calls using the new Signalling System 7 functionality—through the cooperative efforts of Bellcore and the two vendors, AT&T Network Systems and Northern Telecom Inc. (Additional examples of increased cooperation and interaction between the RBOCs and manufacturers were cited in TIA's testimony before

the Subcommittee at its May 9, 1990 hearing concerning S. 173's predecessor, S. 1981.)

Clearly, continued enhancement of the relationship between Bellcore, the BOCs, and the vendor community at large works to the benefit of all parties. Without questions the ability of Bellcore and the BOCs to serve as "honest brokers" among competing manufacturers has made the transition to a multi-vendor environment far easier and more productive. To the bent that the relationship between the BOCs and their suppliers can be improved or strengthened, without creating renewed incentives for discrimination among vendors and other anticompetitive behavior, TIA is supportive of such efforts.

NEED TO RETAIN THE MFJ MANUFACTURING RESTRICTION

TIA believes that action can and should be taken by the Congress to enhance the international competitiveness of U.S. manufacturers in telecommunications equipment markets around the world. However, it would be a grave mistake for Congress to conclude that removal of the MFJ prohibition constitutes a viable means of achieving this objective.

Allowing Bell Operating Company entry into manufacturing will not enhance the competitiveness of U.S. manufacturers in domestic or foreign markets. To the contrary, removal of the MFJ restriction would place at risk the continued leadership of the U.S. in the most critical sector of the telecom equipment industry, i.e., the markets for advanced network switching equipment and related "high-end" telecom products.

As industry analysts at the Commerce Department and in the private sector have observed, the most predictable effect of removal of the MFJ manufacturing prohibition is the formation of RBOC joint ventures with foreign manufacturers, to the exclusion of U.S. firms, in the strategically significant central office switch market and, potentially, in other product areas as well. According to a March 5, 1990 report in Communications Week, summarizing publicly available information concerning filings by Bell Communications Research, Inc. ("Bellcore") under the National Cooperative Research Act of 1984, "almost half" of the 34 joint research ventures undertaken by Bellcore over the preceding 5 year period were with foreign companies. A 1990 Department of Labor staff study focusing on the CO switch market concluded that 18,000–27,000 U.S. jobs could be lost as a result of RBOC alliances with foreign switch manufacturers. In addition, the formation of such alliances would inevitably result in a major shift in BOC purchases away from domestic manufacturers (who currently supply the vast majority of the RBOC's telecom equipment needs) to the BOCs' foreign partners.

Even where the BOCs do not align themselves with foreign interests, renewed foreclosure of domestic equipment markets will make it increasingly difficult for efficient U.S. manufacturers which are not allied with a BOC to obtain the financial support and volume of production they need to compete at home and abroad. In this regard, it is important to recall that it is the independent U.S. manufacturers who were the most aggressive exporters of telecom equipment prior to divestiture. By contrast, the pre-divestiture, integrated AT&T, with its enormous BOC customer base, had only the most limited experience exporting its products, despite its ownership of the largest equipment manufacturer in the world. To the extent that competition in domestic equipment markets is skewed in favor of BOC-affiliated manufacturers, who may well be less efficient and less motivated to aggressively pursue opportunities to compete in foreign markets, the global competitiveness of U.S. industry will be further undermined.

Indeed, the potential adverse impact of allowing BOG entry into manufacturing is likely to be most pronounced for smaller manufacturers, the very group which the BOCs argue would benefit from removal of the MFJ restriction. Many of these firms have proven to be more aggressive, efficient, and innovative than their larger, more well-established rivals, and have grown to a point where they are making a significant contribution to their local economies and to the competitiveness of the U.S. in domestic and foreign equipment markets. Clearly, certain of these firms would be attractive acquisition targets for the RBOCs, and would individually benefit from removal of the MFJ manufacturing prohibition. It is equally clear, however, that those smaller manufacturers and minority-owned firms that are not so favored or that wish to retain their independence will find it far more difficult to survive, notwithstanding the fact that they may be as efficient, or more efficient than BOC-affiliated competitors. A return to closed markets could well be the death knell for all but the chosen few, as investment capital is diverted to the BOCs' preferred suppliers.

In assessing the validity of claims by the RBOCs that removal of the MFJ manufacturing prohibition would yield substantial benefits, it is important to recall the

long history of antitrust litigation which led to imposition of the restriction in the first instance. Entry of the MFJ ended more than 30 years of controversy focusing on the competitive problems associated with AT&T integration into adjacent, potentially competitive equipment markets. The Justice Department's 1949 antitrust complaint focused almost exclusively on the Bell System's efforts to impede competition in the manufacture and sale of telecommunications equipment. In the 1974 litigation, in private antitrust suits, and in numerous proceedings conducted by state and federal regulators, evidence was presented with respect to the BOCs participation in a broad range of anticompetitive conduct, including biased equipment purchasing practices, discriminatory equipment interconnection requirements, and preferential information disclosure practices, as well as the cross-subsidization of equipment prices from monopoly service revenues.

S. 173, in its current form, would permit the BOCs to become involved in all phases of the manufacturing process, thereby giving them renewed incentives to engage in the very practices which operated to limit competition and inhibit innovation throughout the telecom equipment industry for so many years prior to divestiture. Indeed, more limited proposals which would allow the BOCs to engage "only" in product design and other "pre-production" activities pose serious risks to competition and ratepayer interests. In economic terms, fabrication is the least significant facet of the telecom manufacturing business. Moreover, many of the most significant opportunities for cross-subsidization through misallocation of R&D costs) and discrimination in access to network-related information critical to the design of telecom equipment) occur before the fabrication process takes place. Nor would limiting BOC involvement to the product design and development phase eliminate the incentive for biased purchasing practices and other behavior designed to favor equipment which embodies or incorporates a BOC's proprietary design specifications.

Even a single RBOC has the ability as well as the incentive to foreclose up to 15 percent of the U.S. market for many types of equipment, through self-dealing and other forms of anticompetitive behavior. The collective impact of such behavior could result in the foreclosure of more than 70 percent of the market. Nor can the potential for tacit cooperation or outright collusion among the regional companies be discounted, particularly in light of Bellcore's involvement in activities (e.g., standards development, product testing) which have a substantial impact on the ability of manufacturers and suppliers to design and market equipment to the BOCs.

In short, TIA continues to believe that the elimination or substantial modification of the MFJ manufacturing restriction inevitably would undermine the cooperative relationship which as developed between the BOCs and the supplier community under the MFJ, and lead to a renewal of practices which operated to limit competition and stifle innovation in domestic telecom equipment markets prior to divestiture.

"SAFEGUARDS" ISSUES

To its credit, S. 173 recognizes the need to address the threat to competition and ratepayer interests posed by RBOC entry into manufacturing, and includes provisions which would condition removal of the MFJ restriction on BOC compliance with certain regulatory "safeguards". However, significant concerns remain both with respect to the scope and applicability of the proposed safeguards and as to their adequacy to contain the substantial risks of cross-subsidization, self-dealing, and other abuses which necessarily would attend BOC entry into the telecom manufacturing business. Specific concerns presented by various of the proposed "safeguard" provisions contained in S. 173 are described in Attachment D to my testimony.

Should the Subcommittee ultimately determine to proceed with legislation removing or substantially modifying the MFJ manufacturing prohibition, notwithstanding TIA's view that such action is both unnecessary and unwise, TIA would encourage the Subcommittee to further refine and extend the "safeguards" included in S. 173 to include a variety of issues—e.g., federal/state jurisdictional issues; antitrust concerns arising from a continuation of joint BOC involvement, through Be Core, in product testing, standards development, and other areas which have a substantial impact on the telecom manufacturing business—many of which are not explicitly addressed in the bill at present. Appended to my testimony (Attachment E) is a description of various "safeguards" issues which should be addressed as part of any effort to configure a comprehensive framework for BOC entry into manufacturing.

However, TIA strongly urges the Subcommittee, in assessing whether removal of the MFJ restriction is appropriate, to carefully consider both the inherent limitations of regulatory "safeguards," no matter how comprehensive or well-crafted they may be, as well as the substantial direct and indirect costs associated with efforts

by regulators and private parties to control the potential for anticompetitive practices and other adverse effects arising from BOC entry into manufacturing.

Even with a separate subsidiary requirement, regulatory mechanisms can at best merely constrain to some extent the ability of the BOCs to engage in cross-subsidization or discrimination; they do not eliminate the incentive of the BOCs, once integrated into the competitive equipment manufacturing business, to engage in such behavior. Virtually all of the regulatory devices which are now cited as "safeguards" existed in one form or another prior to divestiture. In the equipment procurement area alone, the FCC conducted a series of proceedings spanning several decades in a vain effort to ensure that independent suppliers were given full and fair opportunity to compete for sales to the BOCs. The dramatic shift in BOC purchasing patterns following divestiture vividly demonstrates the inability of federal and state regulators to prevent discrimination by the BOCs in favor of an affiliated cross-subsidization and discrimination in favor of its procurement subsidiary, Materiel Enterprises, over a four-year period following divestiture, make it clear that the risk of such behavior remains both real and substantial. The Justice Department's recent report detailing a series of violations by US West of the MFJ non-discrimination provisions, the manufacturing prohibition, and other line of business restrictions, casts further doubt on the ability of regulatory authorities to prevent the BOCs from abusing any additional freedom they might secure through the enactment of S. 173 or other similar legislation.

By severing the corporate tie between the divested Bell Operating Companies and their affiliated manufacturer (Western Electric, now AT&T Technologies) and prohibiting BOC reintegration into the manufacturing business, the MFJ has sharply reduced, if not wholly eliminated the risks to competition and ratepayer interests which the Justice Department, private litigants, state and federal regulators, and the Congress attempted to contain prior to divestiture. TIA continues to believe that regulatory "safeguards" simply cannot be as effective in ensuring a fully-competitive, efficient, dynamic equipment marketplace as the structural approach embodied in the MFJ.

In addition, as the aforementioned 1990 Department of Labor staff study observed, removal of the manufacturing restriction could have an enormous adverse impact on domestic employment, as a result of RBOC alliances with foreign manufacturers. In its report, the DOL staff further noted that its estimate of potential job losses focused solely on the production (i.e., fabrication) of equipment, and did not take into account "potential adverse effects on employment in research and development functions, much of which might be transferred abroad through RBOC joint ventures with foreign companies."

While the "domestic content" provision included in proposed Section 227(c)(3) purports to address the potential adverse employment impact of eliminating the MFJ manufacturing restriction, a review of this provision indicates that the "protection" afforded by this proposed "safeguard" to U.S. employment interests may be wholly illusory. (A more detailed critique of this section is included in Attachment D to my testimony.) In addition, S. 173 fails to address potential negative impact of removing the MFJ manufacturing restriction on domestic R&D and on U.S. trade policy objectives. Specific areas of concern include the following:

- S. 173 includes a "grandfather" provision which leaves the RBOCs free to manufacture telecom equipment outside the U.S., using foreign components and technology, for sale in overseas markets.
- The "safeguard" provisions included in S. 173 would not preclude an RBOC from entering into commercial arrangements with a foreign manufacturer which would allow the RBOC to share in equipment sales revenues derived from the foreign suppliers offshore fabrication and R&D activities, including revenue generated through the BOCs' own equipment purchases.
- The bill's proposed "domestic content" provision contains an exemption which specifically allows the BOCs' "manufacturing affiliates" to use intellectual property resulting from R&D activities conducted outside the U.S.

This latter provision, if enacted, would serve to further facilitate the formation of alliances between the RBOCs and foreign manufacturers, in which the foreign firm would develop a technology or product and license the resulting intellectual property to the RBOC's manufacturing affiliate. Under such arrangements, the BOC affiliate's role might well be limited to the final assembly of equipment for sale in the U.S. The formation of alliances of this nature would allow foreign suppliers to increase their market share and profits at the expense of U.S. firms, and hand foreign manufacturers a leading role in the evolution of technology critical to our nation's telecommunications infrastructure.

LEGISLATIVE ALTERNATIVES

It is clear that the total cost of removing the MFJ restrictions on entry by the Bell Operating Companies into manufacturing is potentially enormous. The overall "price tag" for MFJ relief is not limited to the direct costs which would be incurred by federal and state regulators, antitrust authorities, and private litigants in their efforts to control anticompetitive behavior by the BOCs; it also includes the more indirect but no less significant costs arising from such practices, which served to sharply reduce the overall efficiency, dynamism, and competitiveness of the U.S. equipment industry prior to divestiture. TIA urges the Subcommittee to carefully weigh these costs, along with the tremendous industry growth and other economic benefits which the MFJ has produced, in considering whether it is truly in the national interest to chart a "new" course for the industry which inevitably will lead us once again down an all too familiar and dangerous path.

In addition, to the extent that the underlying purpose of S. 173 is to enhance the ability of the domestic telecom manufacturing industry to compete on a global basis, TIA would urges the Committee to adopt a more comprehensive approach, one which seeks to preserve the more dynamic and competitive industry structure which has emerged in recent years, while addressing a broad range of issues each of which has a significant impact on the enhancement of our nation's telecommunications resources and the global competitiveness of U.S. industry. TIA's specific recommendations for government action include the following:

- the continuation of efforts to secure increased opportunities for U.S. equipment manufacturers to compete on a fair and equal basis in foreign telecommunications markets, through bilateral and multilateral negotiations and, where negotiations fail to yield results, through appropriate action under the Omnibus Trade and Competitiveness Act of 1988 and other relevant laws;
- continued funding of EXIMBANK's Direct and Intermediary Credit programs, with present funding increased if at all possible and blended with "soft" loans from AID to support export initiatives by U.S. firms;
- revision of export control and licensing policies, with a view towards eliminating unnecessary restrictions which serve to penalize U.S. firms in global competition;
- adoption of a permanent tax credit for research and development expenditures;
- carefully targeted use of government funds to encourage the formation of consortia for "middle ground" or "generic" technology projects in HDTV and other new technology areas;
- reintroduction of an investment tax credit and a graduated capital gains tax;
- continuation of efforts to reduce the budget deficit and achieve a balanced budget, as a means of reducing the cost of capital needed to fund efforts by U.S. manufacturers to expand production and develop new technologies.

In addition, the Congress might wish to consider legislation which, rather than increasing the Bell Operating Companies' opportunities for misconduct, seeks instead to encourage the emergence of meaningful, market-based constraints on the BOCs' ability to abuse their monopoly power, through the introduction of competition into the local telephone business. If properly implemented, such an approach might ultimately provide a viable basis for permitting BOC entry into the telecom manufacturing business, by reducing the need to rely on elaborate, costly, and unproven regulatory "safeguards".

Implementation of some or all of the foregoing recommendations would do far more to promote the competitiveness of U.S. businesses in telecommunications and other areas, at far less risk to our nation's economy, than would the adoption of legislation granting the BOCs relief from the MFJ manufacturing restriction, which has served to increase competition, stimulate innovation, expand consumer choice, and facilitate substantial growth and enhanced efficiency throughout the U.S. equipment industry.

Again, thank you for the opportunity to appear before the Subcommittee. I would be pleased to answer any questions you might have.

Mr. VISHNY. We support, of course, the stated goal of this proposed legislation, that of enhancing this Nation's industrial competitiveness and its competitive position. We believe, however, that the legislation, if enacted, would have a significant adverse impact on consumer welfare, on competitiveness, and, most particularly for us, the competitiveness of the U.S. equipment industry, in both the domestic and foreign telecommunications market.

The telecommunications equipment market in the United States is a vigorous, creative, innovative, productive, and important industry. It does not stand on the brink of disaster. Since divestiture, which gave rise to much of the membership of our association, we have seen an increase in R&D expenditures. We have seen new entries in the market. We have seen new manufacturers enter the American scene to a degree greater than for manufacturing generally in other sectors of our economy. We have seen prices of products fall, new products available for the benefit of the consumer, and equipment available from, of course, a wider range of suppliers.

Much has been said about preserving America's competitiveness in terms of export and foreign markets. This is our goal as well. But what has happened is that, contrary to so many other sectors in the U.S. economy, the trade deficit in telecommunications has fallen drastically in the past year. In addition to that, the leading edge technology in telecommunications has brought to this country a trade surplus which continues.

Our industry is not an endangered species. It is a vigorous industry which continues to deserve your support. Placing these companies, many of whom who have come into existence only in the past several years, at the mercy of a situation which existed predivestiture, is not, we submit, in the best interest of this industry, of the consumer, or of the United States.

Further, we share the opinions of those who do not have confidence in the regulatory system to enforce, to police, and to impose the safeguards that are generally envisioned.

I note with interest a report that appeared in Communications Daily today that this view is shared by a number of State regulators who have expressed their concern about the ability of State regulatory bodies to enforce such safeguards.

We believe that the situation cannot change and should not change until such time as there is a change in the reality which gave rise to the restrictions in the first place. That is, a change in the BOC's ability to abuse their monopoly power which continues to exist through the introduction of competition in the local telephone business.

When that competition is in place, and when that situation has changed, and when the local bottleneck no longer exists, that will be time, I think, to address the removal of the restrictions. Thank you.

Senator INOUYE. Thank you very much.

Mr. Gibson.

STATEMENT OF STUART GIBSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CONCEPT COMMUNICATIONS OF DALLAS, TX

Mr. GIBSON. Mr. Chairman and members of the committee, I am Stuart Gibson, president and chief executive officer of Concept Communications of Dallas, TX. I thank you for the opportunity to offer my views on this very important legislation.

I hope the Senate will pass this legislation. It is a necessary part of a national telecommunications policy, and it is an essential step

to removing the restraints that are inhibiting growth and innovation in telecommunications.

As the president of a small, research and development manufacturing company, I am all too familiar with these restraints and how they continue to frustrate efforts to move this country into the 21st century. In my testimony, I will attempt to show how small manufacturing companies are hurt by the MFJ ban against manufacturing by the Bell operating companies.

But in order to understand how small manufacturers are hurt, it is first important to understand the extraordinary scope of the MFJ's ban against manufacturing by the Bell operating companies. Stated simply, the MFJ prohibits the Bell operating companies from any involvement in any aspect of manufacturing. By prohibiting the Bell companies from engaging in any aspect of the telecommunications manufacturing process, the MFJ implicitly restricts the business activities of every telecommunications manufacturer in this country.

In every industry but telecommunications, a manufacturer is free to structure business relationships with a customer in a way that makes sense for it and for its customers. But in the telecommunications manufacturing industry, this is not so. Instead, independent telecommunications manufacturers are required by the MFJ to limit their business relationships with the Bell operating companies to arm's-length dealings because any closer relationship between a manufacturer and a Bell operating company involves the Bell as a participant in some form of manufacturing.

Let me show, by presenting two examples, how the MFJ ban against Bell participation in manufacturing hurts independent manufacturers like my company. First, let us assume that a small manufacturing company has identified an idea for a new telecommunications product to improve telephone service for the average citizen. But the manufacturer does not know how to design the product in such a way that it will work efficiently with the telephone company who will use it.

For example, should the product be designed so that it can be incorporated into the telephone's central office switch? Should it be placed on the customer premise? Or will it work on other areas in the network? Without close consultation with the telephone company that will use the product, the manufacturer may have no way of knowing the answer to this and thousands of other small questions and details when they design this product.

In any other industry, a manufacturer could readily deal with his potential customer, deal with these questions and work with that customer from the very conception of the product to the final manufacturing. This is not so because of the MFJ.

In the second illustration, let us assume that a telecommunications manufacturing company has come up with a new idea to improve telephone service, and that the manufacturer needs $5 million to complete research and development for that product. It is natural that they would go to someone involved in the telecommunications industry.

But not in this country. They cannot go to seven of the largest telecommunication manufacturers in this country for any form of

research and development funding because that funding is considered part of manufacturing.

Mr. Chairman, my own company has been handicapped by the MFJ. A couple of years ago, our company was approached by U.S. West with an idea that would take our product and integrate it with one of their products. There were preliminary discussions, and then it was determined that we could not work together.

We could not, because those early stages in the research and development are considered part of manufacturing, and because of MFJ, U.S. West was not allowed to work with us.

Although I am here today only on my behalf, I suspect there is a large number of small telecommunications manufacturers who agree with the primary point that I am trying to make in my testimony—namely, that barring the Bell companies from involvement in this manufacturing process hurts small, telecommunications manufacturing companies.

In fact, I am aware of at least 31 small manufacturing companies who already have gone on record in support of allowing the Bell companies to participate in the manufacturing process.

Letters from some of these have already been included in my testimony. As you review these letters, I think you will agree that the stories these companies tell are consistent with the concerns that I have raised. You will learn, for example, that one manufacturing company, Protocol Engines, apparently found that the barriers imposed by the MFJ toward the manufacturing/customer collaboration were so severe, that they discontinued manufacturing products for the public telephone network, and are now dealing with private corporate telecommunications.

You will also read about Synogram Corp., which found it necessary to sell a substantial part of its equity to a foreign communications company after serious efforts to raise this equity from two Bell operating companies failed because of the bar placed by the MFJ.

Collaborative ventures, especially in research and development, are a trend throughout the electronics industry, because the process of developing high-technology products is very expensive. It requires the specialized talents of companies with different kinds of expertise. U.S. companies now spend 31 percent of their semiconductor research and development budgets through technical alliances. It is ironic that, while the ability to engage in collaborative ventures is of growing importance in the electronics industry, generally, close collaboration between telecommunications manufacturers and the largest purchasers of telecommunications products is unlawful.

My own company has a substantial alliance with Harris Corp. Under this alliance, we are developing a product which will be mutually marketed and distributed. The product requires close collaboration, from the early stages in design, through final fabrication. If Harris Corp. were a Bell operating company, this form of reasonable, highly productive, and mutually beneficial relationship would not be possible.

One final point before I conclude. There has been some discussion here today regarding a compromise proposal, which would allow the Bell operating companies to engage in some limited form

of research and development but deny them the right to engage in fabrication. I believe this is an absurdity.

Manufacturing is composed of basic design, applied design, prototype manufacture, and ultimate fabrication. To dissect these into individual parts is to cripple the entire process. I also have troubles with the term, "fabrication." What does that mean? Where does it begin? When does it end? My company as a standard routine takes its product and makes a small run after it has gone through the first prototype. that run inevitably goes back to research and development. Will I be denied that?

I am concerned that if the compromise were to be accepted, I would be sitting here a few years from now, debating the same subject all over again.

I would like to conclude by quoting Edward Roberts, the David Sarnoff Professor of Management of Technology, at the Sloan School at MIT. "In the United States, we have too much political behavior, mixed in with attempts to advance technology. They are not so different from the problems the Japanese encountered and solved. And maybe we will solve them, too, if we get desperate enough."

Gentlemen, I suggest that the time for desperation has arrived. The MFJ has denied all telecommunications manufacturers—small, medium, and large—the critical involvement in the resources and the expertise of 7 of the 50 largest companies in the United States. I urge you to hesitate, and to consider the implications of maintaining the status quo, and of not securing a meaningful place in the 21st century.

Thank you very much.

[The prepared statement of Mr. Gibson follows:]

PREPARED STATEMENT OF MR. STUART M. GIBSON III

Mr. Chairman and members of the committee, I am Stuart M. Gibson, president and chief executive officer of Concept Communications Incorporated of Dallas, Texas. I thank you for the opportunity to offer my views on the important legislation before you. I hope the Senate will pass this legislation. It is a necessary part of a national telecommunications policy, and it is an essential step toward removing the restraints that are inhibiting growth and innovation in our telecommunications industry.

As the President of a small research and development and manufacturing company, I am all-too-familiar with these restraints and how they continue to frustrate efforts to carry the U.S. into the twenty-first century.

In my testimony, I will attempt to show how small manufacturing companies are hurt by the ban in the MFJ against manufacturing by Bell Operating Companies. But in order to understand how small manufacturers are hurt, it is first important to understand the extraordinary breadth of the MFJ's ban against manufacturing by the Bell Operating Companies. Stated simply, the MFJ prohibits the Bell Companies from involvement in aspect of the manufacturing process.

By prohibiting the Bell Companies from engaging in aspect of the telecommunications manufacturing process, the MFJ implicitly restricts the business activities of telecommunications manufacturer in America. In every industry but telecommunications, a manufacturer is free to structure business relationships with its customers in the way that makes sense for it and its customers. But in the telecommunications manufacturing industry, this is not so. Instead, independent telecommunications manufacturers are rehired by the MFJ to limit their business relationships with the Bell Operating Companies to arms-length dealings because any closer relationship between a manufacturer and a Bell Operating Company involves the Bell Company as a participant in some aspect of the manufacturing process.

Let me show, by presenting two different examples, how the MFJ ban against Bell participation in manufacturing hurts independent manufacturing companies like mine. First, let us assume a small manufacturing company has identified an idea

for a new telecommunications product to improve telephone service for the average citizen, but the manufacturer doesn't know how to design that product in a way that is most efficient for the telephone companies who will use it. For example, should the product be designed so that it can be incorporated into the telephone company's central office switch, or should it be designed to be placed in the telephone company's transmission network? Without close consultation with the telephone company that will use the product, the manufacturer may have no way of knowing the answer to this and thousands of other details about how to design the new product to meet the telephone industry needs in the most efficient way possible. In any other industry, the manufacturer could simply go to its customers and work with them directly on these product design questions, but as a telecommunications manufacturer, this close collaboration is unlawful because if Bell Company engineers help the manufacturer design the product, the Bell Company itself is involved in the manufacturing process.

Now let me present a second illustration of how small telecommunications manufacturing companies are hurt by the MFJ's ban against Bell participation in the manufacturing process. Assume that an entrepreneurial manufacturing company has an idea for a new telecommunications product that will improve telephone service for the average American, but the manufacturer needs $5 million to complete R&D in order to develop this product. If the company were in any industry other than telecommunications, it could go to a customer, present the customer with the idea, and seek R&D funding from the customer to help develop the product. As a telecommunications manufacturer, the MFJ bars almost every conceivable type of R&D funding arrangement the manufacturer might consider to enter with the seven companies who may be the manufacturer's largest customers—the Bell Operating Companies.

Mr. Chairman, my own company has been handicapped by the MFJ because my company was unable to develop a close working relationships with the Bell Operating Companies. A couple of years ago, U.S. West approached us with a video conferencing idea. Neither we nor U.S. West was able to produce this product without the other's help. U.S. West believed that there was a mass market for the product. However, due to the MFJ, we were unable to work with U.S. West in the necessary way required to bring our mutual ideas together, because such collaboration would have involved U.S. West in the manufacturing process. Had we been able to work together, we could have developed a product that would have benefited both companies and the public. Instead, the economic health of our company was unnecessarily and adversely affected.

Although I am here today to testify only on behalf my own company, I suspect that a very large number of small telecommunications manufacturing companies would agree with the primary point that I am trying to make in this testimony; namely, that barring the Bell Companies from involvement in the manufacturing process hurts small telecommunications manufacturing companies.

In fact, I am aware of at least 31 small manufacturing companies who already have gone on record in support of allowing the Bell Companies to participate in the manufacturing process. With your permission, I would like to include in the record of this hearing letters which have been written by many of these companies.

As you review these letters, I think you will agree that the stories these companies tell are consistent with the concerns I have raised. You will learn, for example, that one manufacturing company, Protocol Engines, apparently found that the barriers imposed by the MFJ to manufacturer/customer collaboration are so severe that it discontinued manufacturing products for the public telephone network in order to focus on developing products for private corporate communications networks where such collaboration is allowed.

You will read about another company—Centigram Corp. which found it necessary to sell a substantial part of its equity to foreign communications companies after serious efforts to find a way to raise equity capital from two Bell Companies failed because of the bar against Bell participation in the manufacturing process.

Collaborative ventures, especially in research and development, are a trend throughout the electronics industries because the process of developing high technology products is very expensive and requires the specialized talents of companies with different kinds of expertise. United States companies now spend 31 percent of their semi-conductor research and development budgets through technical alliances. It is ironic that, while the ability to engage in collaborative ventures is of growing importance in the electronics industries generally, close collaboration between telecommunications manufacturers and the largest purchasers of telecommunications products is unlawful.

My own company has a substantial alliance with the Harris Corporation. Under this alliance, we are able to develop a product that we will mutually market and

distribute. The product requires a close interaction from the earliest design decisions through that end of the manufacturing process. If Harris Corporation were a Bell Operating Company, this sort of reasonable, highly productive, and mutually beneficial relationship would not be possible.

One final point before I conclude. Some opponents of the bill before this Committee have suggested that they might not object if Congress passed legislation allowing the Bell Companies to engage in limited kinds of R&D while continuing to keep them out of all other aspects of the manufacturing process. With all due respect, any attempt to separate R&D from the rest of the manufacturing process—by allowing Bell participation in the former but not the latter—is absurd! Normal product development involves basic research, applied research, and prototype fabrication. To state artificially that some of these phases are off limits is to cripple the entire process and to introduce serious inefficiencies. It will not work.

I would like to conclude by quoting from Edward B. Roberts, the David F. Sarnoff Professor of Management of Technology at the Sloan School at MIT:

"In the United States we have too much political behavior mixed in with attempts to advance technology. They are not so different from the problems the Japanese encountered, and solved. And maybe we will solve them too, if we get desperate enough."

Gentlemen, I suggest that the time for desperation is here. The MFJ has denied all telecommunications manufacturers—small, medium and large—the critical involvement in resources and expertise of seven of the SO largest companies in the United States. I urge you to hesitate and consider the implications of maintaining the status quo and not securing a meaningful place for the United States in the twenty-first century.

Senator INOUYE. Thank you very much, Mr. Gibson.

May I now call on Mr. Weinstock?

STATEMENT OF MICHAEL S. WEINSTOCK, PRESIDENT, MORSE SECURITY GROUP

Mr. WEINSTOCK. Thank you. My name is Michael Weinstock. I am president of Morse Security Group, and I manufacture a line of alarm equipment.

I am here today on behalf of the Alarm Industry Communications Committee, which represents both the manufacturers and dealers who sell, install, maintain, and monitor burglar and fire alarm systems. Our industry is comprised of over 350 domestic alarm equipment manufacturers, employing 15,000 people, with gross sales in 1990 of $780 million. Approximately 90 percent of the alarm equipment installed in this country is manufactured here in the United States by small businesses. We export nearly one-third, or $240 million of what we produce.

Furthermore, our manufacturers supply nearly 13,000 alarm dealers who employ some 120,000 workers. We urge the committee to keep in mind the vital role our industry in protecting life, safety, and property of millions of Americans. We urge you to carefully weight the alleged benefits of the BOC entry against the potential real damage to consumers and our industry.

As an industry, we support the aims of S. 173 and believe we already meet them. We are already highly developed, competitive, and the undisputed world leader in alarm technological innovation and production. Routinely the Japanese and Europeans purchase their alarm products here from us. The alarm industry's extreme dependence on the local telephone exchange makes us highly vulnerable to unfair competitive activities.

The vast majority of our alarm systems simply do not operate without the telephone network. And as small businesses, it is prohibitively expensive for us to continually challenge BOC intercon-

nection and pricing abuses. If the MFJ manufacturing restrictions are lifted, we believe we will be subject to increased BOC abuse.

If the BOC's were permitted to manufacture alarm equipment, the incentive to sell and install would be irresistible. This not only threatens the manufacturers, but also the dealers who service alarm equipment. Prompt and reliable service, which ensures protection, is extremely marketable. BOC control of the local exchange provides them with opportunities to create delays or outright refusal of equipment hookups, as well as unreasonable delay in providing service, while at the same time denying that they have the ability to identify and repair breaks in service.

BOC entry into manufacturing will provide added incentives to manipulate their control of the networks. In my own company's experience, the introduction of a bridge, which would have allowed alarm companies to poll or interrogate protected premises efficiently was denied. Initially, my new technology was favorably received by my customers and approved by Pacific Bell.

Later the Bell System refused to deploy the technology because of alleged problems, each of which we addressed and proved groundless. I came to learn that AT&T was developing a similar product which they were urging the Bell companies to buy from Western Electric. Ultimately, AT&T's product failed, and we believe our product would have been successful, but the window of opportunity passed us by during the 8 years of costly litigation.

We strongly believe that irreparable harm will come to the alarm industry, if the provisions of S. 173 were to apply to us, and urge the committee to consider providing us with an exemption, much as you did in 1982.

Furthermore, we have carefully reviewed the bill, and have a number of suggestions, which are more fully explained in my formal written testimony, which I have submitted to the committee.

First, the legislation should prohibit the sales of affiliated manufactured equipment within the service area of a BOC. Second, the use of the Bell logo and the name should be prohibited to the BOC affiliates. Their use is extremely marketable and unavailable to anyone else. Current FCC fines are insufficient. Unlawful profit should be returned to ratepayers and competitors. Fourth, the bill should require 12 months public notice of proposed interconnection changes. Fifth, to protect small businesses the FCC should be required to adjudicate a complaint within 45 days. Failure to do so should result in the relief requested. Sixth, we propose the CBO be instructed to estimate the cost of adequately administering S. 173, restrictions should not be lifted until 6 months after those funds are appropriated.

Finally in conclusion, because the alarm industry is already meeting the goals of S. 173 and is comprised of predominantly small businesses which are unusually to BOC anticompetitive activity, we urge the committee to include an exemption for the alarm industry. The exemption should cover manufacturers who are involved in the manufacture of equipment designed to protect life, safety, and property, and where more than 75 percent of the companies are small manufacturers as defined by SBA, and where foreign manufactured components do not exceed 25 percent of the aggregate equipment sales in the United States.

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We believe such standards for an exemption are consistent with the goal of S. 173 and will ensure that a thriving, competitive domestic manufacturing industry will not inadvertently be dismembered or destroyed.

Thank you very much.

[The prepared statement of Mr. Weinstock follows:]

PREPARED STATEMENT OF MR. MICHAEL S. WEINSTOCK

Good Afternoon. My name is Michael S. Weinstock, President of Morse Security Group or Sylmar, California. My company manufactures equipment utilized by the burglar and fire alarm industry, both domestically and internationally. I am here today representing the Alarm Industry Communications Committee (AICC), which is comprised of the Security Industry Association ($1A) (representing manufacturers of alarm equipment), the National Burglar and Fire Alarm Association (NBFAA) and the Central station Alarm Association (CSAA). These latter two organizations represent dealers who sell, install, maintain and monitor alarm systems.

As a threshold matter, we ask Congress to recognize the vital role played by our industry in the protection of life, safety, and property in the United States. The public safety services provided by the Alarm Industry, and the real damage that may be inflicted upon our industry and the public it serves by lifting Modified Final Judgment (MFJ) restrictions on manufacturing, should be carefully weighed against the hypothetical gains that some predict may occur if the alarm manufacturing restrictions are lifted, as proposed in S. 173. Moreover, the threat to the Alarm Industry is exacerbated by the fact that the overwhelming majority of alarm manufacturers, and companies who sell, install, maintain, and monitor alarm equipment, are small businesses possessing limited resources to fend off and survive anticompetitive conduct by the Bell Operating Companies (BOCs).

The AICC supports the goals of S.173 to promote further domestic telecommunications manufacturing. However, we cannot help but note that the Alarm Industry, operating under the current framework, already meets the aims of the bill. Alarm manufacturing in the U.S. has long been a well developed and highly competitive industry; indeed, some analysts believe that it is already over-saturated. Currently, there are approximately 350 companies manufacturing alarm equipment in this country; they employ over 15,000 American workers. Even though the vast majority of these companies are small businesses, in 1990, the industry produced alarm equipment worth approximately $780 million dollars. Nearly a third of that—or approximately $240 million—was exported overseas.[1] Unquestionably, existing American alarm equipment manufacturers are the world in product design and technological innovation. Routinely, the Japanese purchase alarm equipment from American manufacturers. Likewise, most of the panel boxes installed in European homes and businesses to send "break-in" or fire signals to central stations are of American design, and usually of American manufacture.

Furthermore, these 350 manufacturers supply nearly 13,000 American companies engaged in the sale, installation, maintenance and monitoring of alarm equipment. These companies employ over 120,000 workers in the United States.

Perhaps the most striking fact is that approximately 90 percent of the alarm equipment installed in this country is also manufactured here. In short, American companies have historically dominated the world's alarm industry. There is simply no evidence that our preeminent position is seriously challenged by foreign competitors.

Against this industry background, proposals to allow the BOCs into alarm manufacturing or monitoring deserve careful scrutiny. As recognized by the Department of Justice's own expert, Dr. Peter Huber,[2] the Alarm Industry is extremely dependent upon interconnection with the monopoly services and facilities provided by the BOCs. According to Dr. Huber, 90 percent of the burglar and fire alarm systems installed to protect commercial premises are connected to central monitoring stations by dedicated private lines provided by BOCs and other local exchange telephone companies. Dr. Huber also estimated that 95 percent of monitored residential alarm systems are connected to central monitoring stations via local switched telephone lines. As a result of their dependence upon bottleneck telephone facilities,

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[1] Figures supplied by William S. Cunningham, *The Hallcrest Report II: Private Security Trends 1970–2000*, which was commissioned by the National Institute of Justice, a research arm of the U.S. Department of Justice.

[2] Peter W. Huber, *The Geodesic Network: 1987 Report On Competition in the Telephone Industry* at 13.1–13.11 (January, 1987).

alarm companies are extremely vulnerable to discriminatory limitations of access to telephone facilities and other types of unfair competition from the BOCs. For example, delays in BOC response to alarm company orders for installation of necessary new telephone lines, as well as slow or unsatisfactory BOC maintenance of existing lines, will directly delay or disrupt the service of alarm company customers. BOC changes in the protocols and technical standards governing their lines will render existing alarm equipment obsolete, or subject it to expensive modification. Substantial increases during recent years in BOC charges for dedicated private lines have directly and significantly increased alarm company expenses. Finally, it should be noted that Dr. Huber found the potential for BOC cross-subsidization of alarm operations was high for sales, marketing, installation, and monitoring activities, and moderate for dedicated private line and derived local channel services.

The vulnerability of alarm companies is heightened by the fact that, as small businesses, it is extremely costly for us to monitor BOC activities, and to prosecute complaints against them for anticompetitive acts before the FCC and the courts.

Alarm Industry concerns about BOC discrimination, self dealing and cross-subsidization are not hypothetical. In my own company's experience, the BOCs' control of the public network delayed the introduction of a security innovation that would have substantially improved alarm technology at the time. Specifically, my company developed a "bridge" in conjunction with one of the Bell Companies that would have allowed alarm companies to "poll" or interrogate protected premises on a very efficient basis. This innovation occurred in the early 1970s and initially was received favorably our alarm company customers. Soon after the Bell companies almost uniformly claimed there were "problems" with this technology and thus refused to deploy it. When our company addressed each Bell company objection to the technology and proved it to be baseless, new objections surfaced. Later we learned that AT&T was developing a product to compete with our company's product which the Bell companies were all strongly "encouraged" to buy from Western Electric. At the end, the AT&T product was a failure in the alarm industry while in our view our company's product would have succeeded, but the window of opportunity passed us by during the ensuing eight years of litigation. Needless to say, my company was forced to incur substantial expenses and legal fees as a result of this anticompetitive strategy to compete with our equipment.

More anticompetitive Bell company strategies later surfaced that indicated that not just my company, but the entire domestic burglar and fire alarm industry, was the target of AT&T and the Bell companies. Part of this strategy included attempts to dramatically raise the cost of private line facilities utilized by the alarm industry intended to "migrate" alarm companies off of facilities (i.e. to induce customers to relinquish private lines through rate increases) long utilized by us. Several state public utility commissions uncovered this strategy. For instance, in 1982, the Pennsylvania Public Utility commission found: "the evidence is clear that the repricing and restructuring program for private lines is strongly directed to a migration strategy, intended to migrate customers to use of new products eminently to be marketed * * *

Similarly, in 1982, the Public Utilities Commission of Ohio found: "the entry of AT&T and Ohio Bell into the home security business (* * * a foregone conclusion at this point in time * * *) may help to explain some of the underlying reasons for the rate levels proposed in the cost methodology used for pricing private line services * * *"

The Illinois Commerce Commission similarly found that the Bell companies private line costing strategies were for an ulterior motive. The Commission concluded that the objective of this program was to: "allow AT&T to enter the alarm industry with products and services attractively priced compared to those by the alarm companies". Published federal court decisions describe this program, as project "SUNRAY".

Although the divestiture of the Bell System from AT&T has since occurred, it is important to recognize that none of these anticompetitive strategies could have been accomplished without the help and complicity of the BOCs and, indeed arbitrary BOC manipulation of the network today continues to plague the alarm industry.

The Alarm Industry also has experienced ongoing problems with service disruptions of the BOC facilities which we must use. In many instances, the BOCs have acted extremely slowly to identify the causes of service interruptions and problems which alarm companies have reported to them. As a result, alarm companies have often been forced to locate and report the sources of service disruptions to the BOCs, and then have had to wait further unreasonably long periods for the BOCs to get around to making the necessary repairs.

These are the experiences of the Alarm Industry in an environment without the BOCs competing against us. If they were manufacturing and selling their own

alarm equipment, I am firmly convinced that they would have every reason to make it even more difficult for the industry to receive prompt installation and maintenance, adequate numbers of dedicated private lines, quality service, and reasonable rates. No matter how well intentioned the FCC might be, BOC manipulation of the availability, reliability, and cost of the interconnection facilities needed by alarm companies would be extremely difficult for the FCC to discover and stop. Moreover, even where this could be accomplished, the intervening delays and costs would cripple small alarm companies competing with the BOCs.

In addition, given that most new purchases of alarm equipment come from existing customers and from new homes and businesses, the BOCs have an unfair advantage over alarm companies through their ready access to Customer Proprietary Network Information (CPNI). CPNI can easily identify for a BOC which households and businesses are or were customers of a alarm service. Moreover, the BOCs can discover almost immediately new residents and businesses locating within their service areas, since obtaining phone service is an essential initial step for new residents and businesses. BOC access to this information provides them and their affiliates with an insurmountable marketing advantage.

BOC entry into manufacturing will also provide added incentives for them to make sudden changes in network interfaces, thereby rendering non-BOC manufactured equipment obsolete. One recent example illustrates this point. In the mid 1980's, the BOCs, with the permission of the FCC, introduced a new alarm service known as "derived channel" technology. This technology allows an additional signal to be "derived" or piggy-backed over the customer's existing telephone line, and then to be routed to the alarm company to provide alarm information. Unlike a regular telephone circuit, information going over the derived channel only transmits alarm signals and has the same high grade security characteristics of dedicated private lines. The initial cost of such a system for an alarm monitoring company can be substantial. However, alarm companies made the investment in this state of the art technology based upon BOC representations that the technology would be available over the long term, and because the system offers certain advantages over dedicated lines.

Recently, Ameritech, which was a leader in offering this technology, suddenly announced that it will be discontinued. The threatened discontinuation of this service will render obsolete investments in equipment that both the alarm monitoring companies and their customers have made—at a cost of millions of dollars. In Chicago alone, the existing service provided by just one alarm dealer to approximately 1,100 customers is in jeopardy.

This arbitrary manipulation of the telephone network will only get worse if the BOCs are manufacturing equipment that depends on their telephone networks for interconnection. The BOCs will have every incentive to make sure that new generations of equipment manufactured by them will require different protocols and interconnection requirements. In so doing, they will render obsolete the equipment of existing alarm manufacturers. A well-funded BOC manufacturing affiliate will have the resources to respond to frequently changing BOC technical requirements; a small existing alarm manufacturer in many cases will not.

The Alarm Industry is also concerned that, no matter how well-crafted and well-intended the safeguards of S. 173 may be, an underfunded and undermanned FCC cannot possibly fulfill the monitoring and enforcement responsibilities that will be imposed upon it by the bill. We have reviewed the FCC's budgets for the ten-year period from 1980 to 1989. Despite receiving considerable new responsibilities during the decade, the FCC budget (on a CPI adjusted basis) was only $1.7 million greater in 1989 ($77.8 million) than in 1980 ($76.1 million). [An analysis substantiating our findings is attached.]

SPECIFIC COMMENTS ON S. 173

Notwithstanding our concerns about continued unfair BOC practices, the historic inability of the FCC to regulate the BOCs, and the absence of discernible benefits to America's alarm consumers, we recognize that S. 173 is a good faith effort to allow the BOCs into manufacturing. At the same time, the Committee should be commended for its efforts to telecommunications manufacturing in this country. However, we strongly believe that irreparable harm will come to the alarm industry if the provisions of S. 173 were to apply to us and urge the Committee to consider providing us with an exemption. With that in mind, we strongly believe that there are a number of areas where the bill needs to be improved to ensure fair competition should the MFJ restrictions on alarm manufacturing be lifted.

The Legislation Should Prohibit Self-Dealing in Manufacturing

The historical abuses by AT&T and the divested BOCs in the equipment manufacturing sector are a matter of record in the MFJ proceeding. Prior to divestiture, the BOCs purchased almost exclusively from Western Electric Company, often for reasons unrelated to price or quality. Since divestiture, the dramatic increase in telecommunications equipment suppliers indicates the extent to which the discriminatory self-dealing of the AT&T/BOC system had previously suppressed competition. Indeed, this discriminatory self-dealing has continued in the post-divestiture world, as evidenced by the FCC's recent fine of NYNEX for its abuse of affiliated (and unregulated) equipment supply relationships. AICC submits that the appropriate way to protect against discriminatory BOC self dealing with affiliates is to prohibit the BOCs from buying telecommunication equipment manufactured by their affiliates.

Prohibition of Affiliate Manufacturing Sales Within a BOC's Service Area

The principle of prohibiting self-dealing also applies to a prohibition on the sale within a BOC's service area of equipment manufactured by its affiliates. We believe such activity would result in less, rather than more, choice for the consumer. If the BOCs are allowed to manufacture, their manufacturing affiliates will, under the umbrella of the Bell logo, market their equipment to the exclusion of other alarm suppliers, and the parent Bell company will have incentives to engage in subtle anticompetitive manipulation of the network to enhance their affiliates marketing ability. Since alarm manufacturing is already an over saturated industry, entry by the BOCs will at best only shift jobs away from existing manufacturers toward the BOC alarm manufacturing affiliate. This shift of jobs will do nothing to add to Gross National Product, but will result in unemployment for displaced workers in the alarm manufacturing segment. Ultimately, the concentration of this manufacturing capacity will reduce choices available to the consumer, and will hamper innovation in the marketplace.

A prohibition on sales by a alarm manufacturing affiliate, within the BOC service area, will significantly reduce the likelihood of anticompetitive abuses which would arise between the BOCs and their non-regulated affiliates.

We therefore urge that a safeguard be added to the bill that prohibits a manufacturing affiliate from selling equipment within its BOC parent's service area.

Use of the Bell Logo And Name

The current legislation will allow use of the Bell logo and name in non-regulated activities permitted by the bill. The Bell logo and name represent approximately 100 years of goodwill funded by monopoly ratepayers. As such, the BOCs' unregulated manufacturing and information service operations would enjoy a distinct, competitive advantage merely by use of the Bell name and logo. A level playing field would require the prohibition of the use of the Bell logo and name in unregulated activities.

Penalties and Fines

The current draft legislation assumes that existing penalties are sufficient to deter unfair BOC conduct in manufacturing markets. However, the current statutory fines that may be levied for violations for the Communications Act are not sufficient to deter anticompetitive BOC activity, in view of the substantial, non-regulated profits that are available through unfair manipulation of the BOCs' monopoly network. The alarm industry proposes that the legislation be strengthened in order to require that any and all unlawful BOC profits from unfair manipulation of regulated or unregulated operations be returned to the ratepayers and/or competitors. In addition, the BOCs should be fined an amount equal to their unlawful profits. The offending BOCs also should be barred from the competitive activity involved for a period of 25 years. Finally, the legislation should make clear that the FCC's regulation of the BOCs will not shield the BOCs from existing antitrust laws.

Public Notice Should Be Required For BOC Protocols and Interconnection Information

The legislation currently requires that each BOC maintain and file with the FCC information on protocol and technical interconnection. The legislation does not provide for notice to the public that this important information has been filed with the FCC. Because manufacturing markets are extremely sensitive to the time within which network information is received, the legislation should explicitly require public notice, and should specify a time period before the network changes may become effective. We would propose a reasonable time frame to be one year.

Good Faith Effort to Obtain Equivalent Component Parts

We are concerned by the "good faith effort" standard contained within the bill that allows a BOC affiliate to obtain parts from outside the United States. The FCC is given the authority to ascertain whether a BOC has made sufficient efforts to find domestic components if it wishes to rely on up to 40 percent foreign components in its manufacturing process. However, it is our understanding that the FCC, to date, has consistently shied away from making qualitative judgments of this sort. Given the FCCs' history in this respect, we think the Committee, should provide more detailed legislative guidelines. For instance, does good faith effort mean the components cannot be found in this country? or, does it mean that the component cannot be found in this country at a price as low as it could be found in a low wage country outside the U.S.? Experience with the BOCs tells us that they will act strictly according to their economic interests to maximize profits; this would naturally include the ability to purchase up to 40 percent of their component parts overseas if it suits their purposes.

Indeed, prior to the AT&T breakup, a major focus of the BOCs' activity was spent justifying the fact that almost of their telecommunications and switching gear was purchased from Western Electric Company. The organization devoted to justifying these self-dealing purchases was known as the Bell System Purchased Products Division (BSPPD). Now that the corporate I ink has been severed between the BOCs and Western Electric, BOC acquisition of non-Western equipment has occurred at levels that belie BSPPD's earlier claims that affiliated transactions between the BOCs and Western Electric were based purely on price and quality considerations. Thus, we believe that in order to avoid abuse in this area, Congress must define what the standards are for a "good faith effort" in order to prevent a return to the vertically integrated monopoly that existed prior to the divestiture.

We are similarly concerned that the legislation limits the cost of components manufactured outside the United States, to 40 percent of the aggregate of telecommunications and customer premises equipment manufactured by any given BOC affiliate. The legislation, as currently drafted, does nothing to prohibit the gaming of the system by the placing of several product lines, some expensive, some not so expensive, under any given subsidiary. Thus, if expensive switching equipment is included in a subsidiary which sells alarm equipment, 35 percent of switching components could come from overseas, while there would be nothing to prohibit 100 percent of alarm equipment from being manufactured overseas. We would suggest that the standard apply to each product line individually, and not to the aggregate of equipment sold in the United States by any BOC.

Non-discrimination in sales of equipment

I noted with interest the provision of S.173 which requires a given Bell affiliate to make available, without discrimination or self-preference as to price, delivery, terms or conditions, to all local carriers, any telecommunications equipment manufactured by such affiliate as long as this was done on a reciprocal basis. It is commendable that the Committee is concerned with protecting the access of local exchanges to the equipment manufactured by an affiliate of a BOC. But I also find it strange that nowhere in the legislation does a similar protection appear for non-local exchange companies who might wish to purchase Bell manufactured equipment. Shouldn't a local alarm company which is involved in the sale, installation and maintenance of alarm equipment be allowed non-discriminatory access to equipment manufactured by a Bell affiliate? This is especially critical to the survival of individual alarm companies, if as I fear, entry by the Bells into alarm manufacturing will translate into a significantly diminished number of alarm suppliers.

Streamlined Complaint Process—45 days adjudication

S. 173 significantly broadens the jurisdiction and responsibilities of an already resource-short FCC. The added responsibility of policing BOC affiliates entering a myriad of telecommunications manufacturing product lines will certainly result in even further strains on the FCC's ability to carry out its mandates.

The proposed safeguards in the bill will mean nothing to alarm manufacturers and those who sell and install alarm equipment if they can not get the FCC to act on their specific allegations of Bell abuses. As a predominantly small business industry, we are especially vulnerable to financial losses that would result from any extended period in which an anticompetitive activity is allowed to continue. Thus, we would suggest that the FCC be required to adjudicate a complaint within 45 days. Any longer period would result in irreparable losses which would in turn put many smaller alarm companies out of business. Failure to ensure speedy resolution to charges of unfair competition will invite only further predatory activity by the BOCs.

In addition, to insure that the BOCs understand that Congress is serious about the safeguards and prohibitions in S. 173, the relief requested in a complaint should be awarded by the FCC if it fails to resolve a complaint within 45 days. Without such protection, Congress will be leaving many small businessmen extremely vulnerable to BOC abuses.

FCC Resources

The alarm industry strongly believes that S. 173 has failed to address one of the cornerstone issues involved in allowing BOC entry into manufacturing. As we have previously stated, the FCC on a CPI adjusted basis, had only $1.7 million more in 1989 than it had a decade ago to discharge its significantly expanded responsibilities. S. 173 will only add to the FCC's responsibilities, and could wreak havoc in certain telecommunications markets unless adequate funding is provided. Congress has a responsibility to assure companies placed at risk by this legislation, that the necessary funds are made available to the FCC. Thus, we would propose that the Congressional Budget Office (CBO) be given the responsibility to estimate the cost to the FCC of adequately administering S. 173, and that the line of business restrictions not be lifted until six months after the necessary funds have been appropriated. This six month grace period is only a bare minimum for providing the FCC sufficient time to hire and train staff.

CONCLUSION

In conclusion, while the Alarm Industry commends Senator Hollings on seeking to promote domestic manufacturing, we believe that the principles and goals of S. 173 have already been realized by our industry. We are a well developed, highly competitive, domestic manufacturing industry which provides jobs in this country. In addition, we are the world's leaders in alarm technology and innovation, and as an industry we are responsible for significant exports. Thus, there exists little rationale and justification for lifting the line of business restrictions on alarm manufacturing or for that matter alarm monitoring services.

Because we are predominately small businesses which are usually dependent upon the local telephone exchange for the delivery of our service and highly susceptible to anticompetitive abuses by the BOCs, we strongly believe that we should be exempted from any lifting of the MFJ manufacturing prohibition. While the details can be worked out at some time between now and the Committee mark up of S. 173, we believe an exemption should be crafted which covers manufacturers:

- who are involved in the manufacture of equipment designed to protect the life, safety, and property of homes and businesses; and
- which covers manufacturers where more than 75 percent of the companies manufacturing equipment in the product line are small manufacturers as defined by the Small Business Administration—employing 600 or less workers; and
- where for the total sales of equipment manufactured and sold in the United States by any segment of the industry in any given year, the cost of the components manufactured outside the United States contained in the equipment does not exceed 25 percent of the sales revenue derived from such equipment.

We believe that such a standard for an exemption is completely in keeping with goals of the bill and will ensure that a thriving domestic manufacturing segment of the telecommunications industry is not inadvertently dismembered or destroyed.

Senator INOUYE. I thank you very much, Mr. Weinstock.
Mr. Binz.

STATEMENT OF RONALD J. BINZ, PRESIDENT, NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES

Mr. BINZ. Mr. Chairman and members of the subcommittee, my name is Ronald Binz. I am the director of the Colorado Office of Consumer Counsel and the president of the National Association of State Utility Consumer Advocates—also known as NASUCA.

NASUCA is an association of 42 consumer advocate offices in 38 States and the District of Columbia. Our members are designated by State law to represent the interests of utility consumers before State and Federal regulators and in the courts.

We appreciate the opportunity to appear in this hearing today to discuss the effects which S. 173 will have on the consumers we rep-

resent. Our position is found in two resolutions concerning removing MFJ restrictions, which I have attached to my written statement.

Mr. Chairman, our message is short and direct. The unanimous opinion of the members of the NASUCA is that, while S. 173 makes attempts to insulate consumers from the negative effects of the RBOC's entry into telecommunications equipment manufacturing, we do not believe the protections will be effective. We remain opposed to lifting the MFJ restrictions.

As I show in my full, written testimony, S. 173 not only exposes consumers to the risk of higher rates for basic telephone service, the legislation also fails to provide any discernible direct benefits for telephone ratepayers. In fact, RBOC entry into telecommunications equipment manufacturing may put at risk one of the few direct consumer benefits to be found in the divestiture and in the introduction of competition in the telecommunications industry—namely, customer choice and lower equipment prices.

In my written testimony I make four points, which I would like to elaborate slightly in these remarks. First, the size, complexity, market power and regulatory status of the RBOC's distinguish them from other members of the telecommunications industry. These qualities provide these companies with the incentive and the ability to engage in anticompetitive behavior and to direct subsidies to competitive ventures.

By now the members of the subcommittee are familiar with the numerous allegations and instances of monopoly abuse by the regional holding companies and their subsidiaries. The stories of cross-subsidization, unfair cost allocations, discriminatory pricing and unfair marketing practices are linked by one common theme: they are all possible because of the existence of a near total monopoly which the RBOC's have in the provision of basic, local telephone service.

Consider these examples of RBOC overreaching and illegal behavior: We have already discussed the $10 million fine against U.S. West for violating the MFJ restrictions. NYNEX has been indicted on contempt charges for violating the MFJ. Bell of Pennsylvania has agreed to pay a $42 million fine as a settlement of charges by the Pennsylvania consumer advocate that it used deceptive sales practices in selling telephone features.

Bell South has recently paid $4.86 million in Florida to settle charges of underpaying pay phone commissions. Pacific Bell was ordered to refund $63 million to California customers and pay a $16 million penalty as a result of the California PUC's finding that certain marketing practices were improper.

The behavior of the regional holding companies has become so widely discussed, it is even a feature story in the current issue of Business Week. Under the headline of "The Baby Bells Misbehave," the magazine recounts some of the better known abuses of U.S. West, NYNEX, Bell Atlantic, and Bell South.

There is a natural and understandable reluctance to restrict the activities of any business operating in the U.S. economy. The RBOC's have certainly exploited that reluctance in their advertising campaign aimed at the MFJ restrictions.

I have attached a copy of an ad run by U.S. West in Colorado which shows a school child with a lunch pail in hand, standing under a headline which reads, "Courtney Gimble Lives in a Country that Limits the Flow of Information to Its Students, the U.S.A." In fact, Courtney Gimble lives in a country that encourages competition and limits the opportunities for antitrust behavior.

The question is not whether the MFJ restrictions are good or bad, but whether they are necessary. What are we to make of these instances of abuse of monopoly power by the RBOC's? I submit that all of the instances serve as evidence of a single proposition. It does not seem that the RBOC's can be trusted to play by the rules.

The reasons why this is true are complex. They do not include the fact that these companies are venal. Instead, they are provided by virtue of their significant role as the near-monopoly provider of local telephone service with an irresistible opportunity to make extra money in their pursuits.

There is an additional reason why the Bell companies have undertaken or accomplished these unsavory practices. For the vast majority of consumers, their local telephone company is still viewed with trust as the consumer's essential link to friends, family, business, and other necessities. I submit that the combined effects of this trust of the local exchange company, with the market power which they possess, justifies extraordinary restrictions like those contained in the MFJ.

My next point: cross-subsidies developing as a result of RBOC entry into telecommunications equipment manufacturing will be mainly State regulatory problems, not Federal issues. The subcommittee has heard from FCC chairman Alfred Sikes that the FCC now possesses adequate safeguards to protect ratepayers and competitors from the effects of cross-subsidies which might otherwise occur if the RBOC's enter telecommunications manufacturing.

But what Mr. Sikes neglects to say is that the substantial majority of the revenues of local telephone companies is regulated at the state level, not at the federal level. Even if Mr. Sikes is correct and the combination of price caps, ONA, and authority to level fines at the FCC is a potent deterrent—a claim we seriously doubt—there can be no dispute that the states are not similarly equipped.

In general, State public utility regulators, armed with the best intentions, are not adequately funded and legally equipped to ensure that monopoly consumers pay fair rates. In many cases, the authority of State regulators has been lessened under recent statutory changes. The experience in the U.S. West States, with which I am familiar, shows a chipping away of State authority to regulate at all, much less to regulate well.

NASUCA's conclusion about regulators' capacity to protect consumers from inappropriate costs? We disagree with Chairman Sikes' optimistic appraisal. We think a much more realistic assessment is that manufacturing entry by the RBOC's will add to the state regulators' already considerable burden. This puts consumers at risk.

My third point, Mr. Chairman, and I am almost finished. Telephone consumers should not expect to benefit from the entry of RBOC's into the telecommunications manufacturing business. The very best outcome under this legislation is that there will not be

harm to the basic ratepayer. Instead, if the manufacturing restriction is lifted, consumer protection should be added to ensure that consumers actually benefit from such a fundamental change in telecommunications policy.

It is generally acknowledged that the RBOC's have no special expertise in manufacturing telecommunications equipment. This leads consumer representatives to ask why the RBOC's are so interested in entering the manufacturing area. To us, there is only one reasonable answer. Despite the fact that this is a highly competitive industry, the RBOC's believe they can make money in it.

Our concern is that these companies will enter and operate in the same fashion as predivestiture, including self-dealing of switching equipment at favorable terms to manufacturing subsidiary, market foreclosure, and cross-subsidies.

Given this setting, there is a fundamental belief among consumer advocates that in the very best case, consumers of basic telephone service will simply not be harmed by RBOC entry into equipment manufacture. Stated another way, if all of the protections worked, if every attempt at a cross-subsidy were detected and intercepted, patriot missile-style, then consumers would be merely no worse off.

Since none of us believe that all, let alone most, abuses will be detected and stopped, we must insist that an explicit consumer dividend or exogenous consumer benefit be adopted before restrictions are lifted.

My final point. Competition has served consumers well in the telephone equipment market. Most dramatically in the area of customer premises equipment. We should resist attempts to lessen fair competition, since that will sacrifice a known consumer benefit.

NASUCA recognizes that substantial consumer benefits have been derived from the introduction of competition in the provision of telecommunications equipment. Customers who once had only the choice of a plain black telephone can now choose from an amazing array of telephone equipment, from cheap to expensive, from simple to sophisticated.

In the telecommunications equipment market, including PBX's and telephone switching equipment, the consumer benefit has been less direct, but no less real. Rivalry among manufacturers of switching equipment has resulted in a very competitive market for those products, one which has lowered costs for all types of telephone services.

This committee has heard conflicting testimony about the effects which entry of the RBOC's will have in the equipment manufacturing business. We observe that if the critics of RBOC entry are correct, and customer choice and price are negatively affected, than this legislation will begin to erode one of the clearest consumer benefits to come out of divestiture in the accompanying push toward competition in the telecommunications industry: Customer choice and lower costs associated with telephone equipment.

We do not take a position in the debate of how RBOC entry will affect either U.S. competitiveness or the structure of the U.S. communications equipment manufacturing business. However, we do reassert the link between what we believe is the certainty of cross-subsidies and the manner in which that manufacturing sector will develop.

In conclusion, NASUCA respectfully requests that you weigh carefully the adverse ratepayer consequences of opening up telecommunications manufacturing to the RBOC's. Consumer advocates are uniquely positioned to predict harm to consumers from this type of RBOC activity. We respectfully urge you to continue protecting ratepayers from cross-subsidies by maintaining the restrictions on RBOC entry into telecommunications equipment manufacturing.

[The prepared statement of Mr. Binz follows:]

PREPARED STATEMENT MR. RONALD J. BINZ

Mr. Chairman and members of the Subcommittee, my name is Ronald J. Binz. I am the Director of the Colorado Office of Consumer Counsel and the President of the National Association of State Utility Consumer Advocates (NASUCA). NASUCA is an association of 43 consumer advocate offices in 38 states and the District of Columbia. Our members are designated by state law to represent the interests of utility consumers before state and federal regulators and in the courts.

We appreciate the opportunity to appear in this hearing today to discuss the effects which S. 173, The Telecommunications Equipment Research and Manufacturing Act of 1991, will have on the consumers we represent. NASUCA's position is found in two resolutions on removing the MFJ restrictions which I have attached to this statement. I will discuss each resolution later in this testimony.

Our message is short and direct: The unanimous opinion of the members of NASUCA is that, while legislation like S. 173 makes some attempts to insulate consumers from the negative effects of the RBOCs entry into telecommunications equipment manufacturing, we do not believe these protections will be effective. We remain opposed to lifting the MFJ restrictions.

S. 173 will permit the Regional Bell Operating Companies to engage in telecommunications manufacturing activities from which they are now barred. NASUCA's position is that the ability of the Bell Operating companies, directly and indirectly, to charge their captive customers for some of the costs associated with these manufacturing activities cannot be effectively inhibited by legislation. The result for ratepayers is predictable: telephone rates that are higher than they need to be.

As I will show in this testimony, S. 173 not only exposes consumers to the risk of higher rates for basic telephone service, the legislation also fails to provide any discernible direct benefits for telephone ratepayers. In fact, RBOC entry into telecommunications equipment manufacturing may put at risk one of the few direct consumer benefits to be found in the divestiture and the introduction of competition in the telecommunications industry: customer choice and lower equipment prices.

Here are the main points of my testimony:

- The size, complexity, market power and regulatory status of the RBOCs distinguish them from other members of the telecommunications industry. These qualities provide these companies with the incentive and the ability to engage in anti-competitive behavior and to direct subsidies to competitive ventures. Historic abuses and recent revelations underscore that the "bottleneck" nature of their business has not changed.
- The cross-subsidies which develop following RBOC entry into telecommunications equipment manufacturing, will result in regulatory problems which are largely state, not federal, issues. We must examine the state commissions' willingness and ability to protect consumers.
- Telephone consumers should not expect to benefit from the entry of RBOCs into the telecommunications manufacturing. The best outcome under this legislation is that there will not be harm to the basic ratepayer. If this restriction is lifted by Congress, consumer protections should be added to ensure that consumers actually benefit from such a fundamental change in telecommunications policy.
- Competition has served consumers well in the telephone equipment market, most dramatically in the area of Customer Premises Equipment. We should resist attempts to lessen fair competition since that will sacrifice a known consumer benefit.

The size, complexity, market power and regulatory status of the RBOCs distinguish them from other members of the telecommunications industry. These qualities provide these companies with the incentive and the ability to engage in anti-competitive behavior and to direct subsidies to competitive ventures.

While certain aspects of the telecommunications industry have undergone massive change in the past ten years, other aspects have not changed much at all. For exam-

ple, residential and small business telephone consumers rarely have more than a single choice for local telephone service. Long-distance carriers still rely primarily on the local exchange companies to originate and complete long-distance calling. Many other consumer services, from answering services to burglar alarms to data transmission depend on the local exchange telephone companies to provide local connections necessary for the product.

By now the members of this subcommittee are familiar with the numerous allegations and instances of monopoly abuse by the Regional Holding Companies and their subsidiaries. These stories of cross-subsidization, unfair cost allocations, discriminatory pricing and unfair marketing practices are all linked by one important common theme: they are possible because of the existence of the near-total monopoly of the RBOCs in the provision of basic local telephone service.

Consider these examples of RBOC over-reaching and illegal behavior:

- US West is fined $10 million for discriminatory pricing, providing information services and manufacturing, in violation of the MFJ.
- NYNEX has been indicted on criminal contempt charge for violating MFJ restrictions information services.
- NYNEX is fined for inflating charges of its Materiel Resources subsidiaries, passing these inflated costs to basic ratepayers.• US West has offered to settle a class-action lawsuit involving its sale of inside wire maintenance services to customers on a "negative option" sales contract. Terms of the settlement will result in tens of millions of dollars in refunds.
- Bell of Pennsylvania has agreed to pay $42 million as a settlement of charges by the Pennsylvania Consumer Advocate that it used deceptive sales practices in selling telephone features.
- BellSouth paid $4.86 million in Florida to settle charges of underpaying pay phone commissions.
- Pacific Bell was ordered to refund $63 million to California customers and pay a $16 million penalty as a result of the California PUC's finding that certain marketing practices were improper.

The behavior of the Regional Holding Companies has become so widely discussed it is even a feature story in the current issue of Business Week. Under the headline of "The Baby Bells Misbehave" the magazine recounts some of the better-known abuses of US West, NYNEX, Bell Atlantic and BellSouth. I have attached a copy of the Business Week article to this testimony.

There is a natural reluctance to restrict the activities of any business operating in the United States economy. The RBOCs have certainly exploited that reluctance in their advertising campaign aimed at the MFJ restrictions. I have attached a copy of an advertisement by US West in Colorado which shows a school child with lunchpail in hand standing under a headline which reads: "Courtney Gimble lives in a country that limits the flow of information to its students, The U.S.A."

In fact, Courtney Gimble lives in a country that encourages competition and limits the opportunities for illegal anti-trust behavior. The question is not whether the MFJ restrictions are good or bad, but whether they are necessary. We must examine the predicates on which the Modification of Final Judgment was entered and approved by the court and ask the fundamental question: Is there reason to believe that the abuses which lead to the anti-trust action of the Department of Justice will not re-occur if the RBOCs are allowed to enter the lines of business proscribed by MFJ?

What are we to make of these instances of the abuse of monopoly power by the RBOCs? The Business Week article notes that even the report of the $10 million fine against US West has been given a positive spin by the company's lobbyists. Despite this gloss, I submit that all of these instances serve as evidence of a single proposition: the RBOCs cannot be trusted to play by the rules.

The reasons why are complex. They do not include the fact that these companies are venal. Instead, they are provided, by virtue of their significant role as the near monopoly Provider of local telephone service with an irresistible opportunity to make extra money in their pursuits.

There is another reason why the Bell companies have undertaken or accomplished these unsavory practices: for the vast majority of consumers, their local telephone company is still viewed with trust as the consumer's essential link to friends, family, business and other necessities.

Cross-subsidies developing as a result of RBOC entry into telecommunications equipment manufacturing will be mainly state regulatory problems, not federal issues.

This subcommittee has heard from FCC Chairman Alfred Sikes that the FCC now possesses adequate safeguards to protect ratepayers and competitors from the effects of cross-subsidies which might otherwise occur if the RBOCs enter telecom-

munications manufacturing. But what Mr. Sikes neglects to say is that the substantial majority of the revenues of the local phone companies happens is regulated at the state level, not at the federal level. As I mentioned earlier, NASUCA members are quite familiar with regulation of telecommunications companies at the state level. Mr. Sikes' confidence concerns us.

Even if Mr. Sikes is correct that the combination of ARMIS, price caps, ONA and authority to levy fines at the FCC is a potent deterrent, a claim we seriously doubt, there can be no dispute that the states are not similarly equipped. In general, state public utility regulators, armed with the best intentions, are not adequately funded and legally equipped to ensure that monopoly consumers pay fair rates. In many cases the authority of state regulators has been lessened under recent regulatory changes. The experience in the US West states, with which I am familiar, shows a chipping away of state authority to regulate at all, much less to regulate well.

There are several reasons why such issues as cross-subsidization are difficult to treat at the state level. Some of the difficulties are quite plain: insufficient resources compared to the legal and technical resources of the RBOCs; limited access to data from RBOC subsidiaries, short timeframes in which cases must be heard; the problem of burden of proof resting on the consumer advocate, etc. Other hurdles include the difficulty of measuring cross-subsidies and the difficulty of estimating the additional risk borne by monopoly ratepayers when an RBOC enters lines of business that are relatively more risky than local telephone service.

NASUCA's conclusion about regulators' capacity to protect consumers from inappropriate costs? We disagree with Chairman Sikes' optimistic appraisal. We think a much more realistic assessment is that manufacturing entry by the RCOCs will add to state regulators already considerable burden. Clearly, doing so puts consumers at risk.

Telephone consumers should not expect to benefit from the entry of RBOCs into the telecommunications manufacturing. The very best outcome under this legislation is that there will not be harm to the basic ratepayer. Instead, if the manufacturing restriction is lifted, consumer protections should be added to ensure that consumers actually benefit from such a fundamental change in telecommunications policy.

It is generally acknowledged that the RBOCs have no special expertise in manufacturing telecommunications equipment. To the extent that the former AT&T possessed such expertise, the divestiture agreement removed that function from the surviving Bell companies. Although allowed to enter other electronic manufacturing businesses, such as consumer electronics manufacturing, the RBOCs have not shown an interest. This leads consumer representatives to ask why the RBOCs are so interested in entering the manufacturing area. There is only one reasonable answer: despite the fact that this is an highly competitive industry, the RBOCs believe they can make money in it. Our concern is that these companies will enter and operate in the same fashion as pre-divestiture, including self-dealing of switching equipment at favorable terms to the manufacturing subsidiary, market foreclosure and cross-subsidies.

Any RBOC Senior Financial Officer will tell you that the companies will invest in activities where returns are highest, commensurate with risk. Given this setting, there is a fundamental belief among consumer advocates that, in the very best case, consumers of basic telephone service will simply not be harmed by RBOC entry into equipment manufacture. Stated another way, if all of the protections worked, if every attempt at cross-subsidy were detected and intercepted Patriot-Missile-style, then consumers will be merely no worse off. Since none of us believe that all, let alone most, abuses will be detected and stopped, we must insist on an explicit consumer dividend or exogenous consumer benefit be adopted before restrictions are lifted.

This idea was clearly expressed by NASUCA in its November 1989 resolution on lifting the manufacturing restriction. The resolution states that any legislation lifting restrictions must contain safeguards which * * * not only leave monopoly telephone ratepayers no worse off as a result of RBOC entry into equipment manufacturing but will provide a net economic benefit to all ratepayers.

The concept of a positive consumer benefit is central to our approach to this legislation. However, I want to reiterate, NASUCA remains opposed to lifting the restrictions. Adding a consumer benefit simply makes a bad idea better.

Competition has served consumers well in the telephone equipment market, most dramatically in the area of customer premises equipment. We should resist attempts to lessen fair competition since that will sacrifice a known consumer benefit.

The divestiture of the operating telephone companies from AT&T was a watershed event in U.S. telecommunications policy. Many Americans associate divestiture with the beginning of customer choice in certain telecommunications markets. Of course,

this is only partially true. Divestiture was both a reaction to and an endorsement of a policy initiative begun years earlier at the Federal Communications Commission to introduce competition as a market forces in the telecommunications services in the United States would best be served by the introduction of competition.

NASUCA recognizes that substantial consumer benefits have been derived from the introduction of competition in the provision 9f telecommunications equipment. Customers who once had only the choice of a plain black telephone now can choose from an amazing array of telephone equipment from cheap to expensive, from simple to sophisticated.

In telecommunications equipment, including PBXs and telephone switching equipment, the consumer benefit has been less direct but no less real. Rivalry among manufacturers of switching equipment has resulted in a very competitive market for those products, one which has lowered costs for all types of telephone services.

As an example, in Colorado, US West recently let a bid for more than one hundred digital switches to complete the upgrade of switching services in rural Colorado. The company was able to select among several competing suppliers, on price, specifications and other terms. Prior to the separation of equipment manufacturing and local switching operations in the old Bell system, customers of rural Colorado likely would not have benefited from competition.

This committee has heard conflicting testimony about the effects which entry of the RBOCs will have in the equipment manufacturing business. We observe that, if the critics of RBOC entry are correct and customer choice and price are negatively affected, then this legislation will begin to erode one of the clearest consumer benefits to come out of divestiture and the accompanying push towards competition in the telecommunications industry: customer choice and lower costs associated with telecommunications equipment.

We do not take apposition in the debate of how RBOC entry will affect either U.S. competitiveness or the structure of the U.S. telecommunications equipment manufacturing business. However we do re-assert the link between what we believe is the certainty of cross-subsidies and the manner in which that manufacturing sector will develop.

In conclusion, NA5UCA respectfully requests that you weigh carefully the adverse ratepayer consequences of opening up telecommunications manufacturing to the RBOCs. Consumer advocates are uniquely positioned to predict the harm to consumers from this type of RBOC activity. When our views are shared by others, as you have heard on this panel, we believe that Congress should conclude that the adverse impact we predict is highly likely to occur. We respectfully urge you to continue protecting ratepayers from cross-subsidies by maintaining the restrictions on RBOC entry into telecommunications equipment manufacturing.

NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES RESOLUTION—OPPOSING LIFTING THE LINE OF BUSINESS RESTRICTIONS ON THE BELL REGIONAL HOLDING COMPANIES

Whereas, there are proposals pending before the United States District Court and considerations in the Congress of the United States to remove the line-of-business restrictions imposed upon the Bell Operating Companies (BOCs) and the Regional Holding Companies (RHCs) at divestiture;

Whereas, lifting line-of-business restrictions will create a situation in which there is a substantial likelihood that monopoly telephone customers of the BOCs will subsidize the RHC activities in new lines of business;

Whereas, the obstacles faced by regulators and consumer advocates in identifying and preventing such cross-subsidization are so substantial it is likely they will not be overcome;

Whereas, many of the same conditions which led to the proscription against entry into these markets at divestiture still exist; and

Whereas, the entry by the RHCs into new lines of business will not provide benefit to the consumers of basic telecommunications service;

Therefore, be it resolved that, the National Association of State Utility Consumer Advocates opposes lifting the line of business restrictions imposed on the RHCs.

Be it further resolved that, if line of business restrictions are removed, local telephone service consumers of the BOCs must be protected against the use of local telephone service revenues to subsidize new business ventures. These protections must include limiting entry into the proscribed businesses to the BOCs in their individual corporate capacities (as opposed to the RHCs). State regulators must have the authority to approve or disapprove new business ventures and be able to pre-

vent cross-subsidization through such regulatory requirements as structural separation, accounting controls and royalty payments.

Be it further resolved that, unless such significant consumer protections are instituted to control possible abuses created by the removal of line-of-business restrictions on the RHCs. The BOCs should be divested from the RHCs.

Be it further resolved that, the National Association of State Utility Consumer Advocates authorizes its Executive Committee to develop specific positions consistent with the terms of this resolution and to present such positions in the courts of the United States, in regulatory proceedings, legislative hearings, and other public forums where the issues set forth in this resolution arise.

NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES RESOLUTION—EXPRESSING CONTINUED OPPOSITION TO REMOVAL OF MODIFIED FINAL JUDGMENT (MFJ) RESTRICTIONS ON REGIONAL BELL OPERATING COMPANY (RBOC) ENTRY INTO TELECOMMUNICATIONS EQUIPMENT MANUFACTURING AND URGING THE REQUIREMENT OF A SEPARATE SUBSIDIARY IN ANY ACTS OF THE CONGRESS OF THE FCC TO LIFT MFJ RESTRICTIONS ON EQUIPMENT MANUFACTURING BY THE REGIONAL BELL OPERATING COMPANIES

Whereas, NASUCA has historically opposed and continues to oppose removal of MFJ restrictions on RBOC entry into telecommunications equipment manufacturing; and

Whereas, the Regional Bell Operating Companies are seeking removal of the restrictions of the MFJ barring their entry into telecommunications equipment manufacturing; and

Whereas, any loosening of the MFJ restrictions on equipment manufacturing by the RBOCs poses the substantial threat that telephone ratepayers will subsidize RBOC manufacturing activities;

Therefore, be it resolved that, the National Association of State Utility Consumer Advocates (NASUCA) urges that, if the Congress of the Federal Communications Commission (FCC) acts to loosen or remove the MFJ restrictions on RBOC entry into telecommunications manufacturing, the RBOCs be required to conduct such business through a fully separate subsidiary which does not share personnel, facilities or expenses with the RBOCs' core telecommunications businesses.

Be it further resolved that, if action is taken by the Congress or the FCC to loosen or remove MFJ restrictions or equipment manufacturing by the RBOCs, such an act must contain safeguards which would not only leave monopoly telephone ratepayers no worse off as a result of RBOC entry into equipment manufacturing but will provide a net economic benefit to all ratepayers.

Be it further resolved that, the National Association of State Utility Consumer Advocates authorizes its Executive Committee to develop specific positions consistent with the terms of this resolution. The Executive Committee shall advise the membership of any proposed action prior to taking such action if possible. In any event the Executive Committee shall notify the membership of any action taken pursuant to this provision.

[Business Week, Mar. 4, 1991]

THE BABY BELLS MISBEHAVE

THE PAST YEAR HAS BROUGHT A RASH OF INDICTMENTS, SETTLEMENTS, AND FINES

(By Peter Coy and Mark Lewyn, Sandra D. Atchison, and Gail DeGeorge)

A skilled spin doctor can put almost anything in a good light—even a $10 million fine. When U.S. West Inc. was penalized that amount on Feb. 15 for violating the Bell System breakup consent decree, lobbyists for the Baby Bells argued that the rules were fuzzy, the infractions were minor, and that, in any case, the antitrust decree that U.S. West violated ought to be drastically curtailed. Indeed, John J. Connarn, vice president for regulatory affairs at rival Baby Bell Ameritech, even argued that the fine could help U.S. West—by calling attention to what he sees as the pettiness of the restrictions. Said the lobbyist: "The things they're being fined for, 98 percent of the business people in this country would be astonished they couldn't do."

That may well be. It's not easy for the average phone customer to fathom the intricacies of the antitrust consent decree that broke up American Telephone & Telegraph Co. in 1984, creating the seven Baby Bells. But the past year has brought a rash of fines, settlements, and allegations against the Baby Bells, many of them

for violations that are all too easy for the general public to understand. Last April, for example, Bell of Pennsylvania agreed to pay $42 million to settle state charges that it used deceptive practices to sell customers more phone services than they wanted. One investigator posing as a single welfare mother was hooked up for $28.55 a month, including extras like 38-number speed dialing, even though she could have gotten basic service for as little as $6.65.

Most of the Bells' legal troubles fall into two categories: violations of the Bell System breakup decree, as in the U.S. West case, or overzealous marketing of services, as in the Bell of Pennsylvania case. Both reflect increasing aggressiveness on the part of the Bells, which believe they're being treated by regulators as staid utilities even as they lay out strategies to be 21st century, information-technology giants. Yet by pressing too hard, they risk a regulatory backlash and even more restrictions.

Indeed, New York regulators have been so swamped with allegations against NYNEX Corp. that last fall, they raised the last-resort possibility of splitting it up into regulated and unregulated companies—sort of a Bell System breakup, round two. "It's very hard to argue that the federal mechanisms to control the Bells are adequate when you see conduct of the type that NYNEX was engaged in," says Scott J. Rafferty, a former NYNEX employee now suing for wrongful discharge. His whistle-blowing led to a criminal indictment of NYNEX on antitrust charges. Rafferty's opinions don't necessarily reflect those of his new employer, the Maryland Public Service Commission. For its part, NYNEX says the charges were isolated incidents that were contrary to company policy.

A SERIOUS MATTER

Federal officials maintain that their enforcement policies have been tough. The fine against Englewood, CO-based U.S. West was the biggest antitrust penalty ever levied by the Justice Department against one defendant in a civil case. "The size of the fine is large enough so that people will realize that this is a serious matter," says Connie K. Robinson, who heads the Justice Department unit that fined U.S. West. "We plan to continue vigorously to enforce this decree."

Industry critics say the case is a textbook example of why the Baby Bells shouldn't be treated as ordinary companies. They argue that the Bells' local monopolies make it possible for them to compete unfairly by controlling access to their captive local customers. The core charge in the latest case was that U.S. West promised the federal government a discount on access to its local customers if the government would also buy switching services from it rather than from AT&T, its erstwhile parent. The violation of rules against discriminatory pricing was an honest mistake, says U.S. West Executive Vice President Charles M. Lillis, adding: "We wish like heck we hadn't done that."

That's a common reaction. Take Bell-South Corp.'s Southern Bell unit, which has been caught in a string of violations. Last year, hundreds of its employees wrote letters to North Carolina regulators urging approval of Caller I.D.—without identifying themselves as Southern Bell workers. Several employees said they were directed or urged to write the letters. The company says it was all a misunderstanding—and that it will restrict future letter writing campaigns. And on Feb. 19, the company agreed to pay $4.86 million in Florida to settle charges that it shortchanged thousands of businesses and government agencies on pay-telephone commissions. It's also under scrutiny for failing to pay refunds for out-of-service phones.

PLAYING ON FEARS

The Baby Bells' aggressive tactics have been aimed at some vulnerable targets. Pacific Bell, Wisconsin Bell, and Southern Bell as well as Bell of Pennsylvania have all made refunds to customers under supervision from state regulators. Affidavits from former Wisconsin Bell customer-service representatives say they were instructed on how to play on the fears of unwell elderly people to get them to sign up for three-way calling at $3 a month—just in case they had to consult family members on going to the hospital. Wisconsin Bell says that those were isolated cases and rules have been tightened.

There's nothing wrong with clever marketing, of course. And even somewhat sharper practices can be remedies by the marketplace. But as Philip McClelland, an assistant state consumer advocate in Pennsylvania says: "If you go to a car dealer, and you feel as if they are not being honest with you, you can always go to another car dealer who treats you more appropriately." Customers of local phone companies don't have that option. As long as that remains the case, the Baby Bells will be subject to extra heavy scrutiny—no matter what the spin doctors say.

[Aurora Sentinel, Nov. 22, 1989]

COURTNEY GIMBLE LIVES IN A COUNTRY THAT LIMITS THE FLOW OF INFORMATION TO ITS STUDENTS—THE U.S.A.

Courtney Gimble likes her local school. She has lots of friends there and is getting a pretty good education. Courtney's school, like all Colorado schools, doesn't have all the resources that are possible.

But imagine if Courtney's school could stretch its resources and have access to some of the programs from distant learning centers such as colleges or universities in other towns or states. Courtney Gimble would be better off and so would American education.

Researchers at US West have the know-how to transmit two-way video signals over the existing telephone network. They envision a low-cost system of distance learning enabling a teacher in one school to give instruction to students at another school. Any Colorado school could supplement its faculty and expand its course offerings.

But US West has had to shelve its work on two-way video. It is not permitted to design and develop such a system, or to give a would-be manufacturer detailed technical specifications, guidance or financial support.

A 1984 court decree broke up the Bell System, forming US West and seven other regional phone companies. Very narrow limits were imposed on what these companies could do. Design and development work is prohibited.

Distance learning is not a new concept, but to date it's been a costly one, requiring expensive equipment and an enhanced telephone network. As a result, it has not enjoyed widespread use. If US West was able to perfect and deploy its two-way video system, improved educational opportunities would be available to Courtney Gimble and her friends.

Court restrictions on US West and the other regional companies add new meaning to the phrase "only in America." You can help change that. Legislation that would remove some of the restrictions on the former Bell companies is currently before Congress. Now is a good time to write a short letter to your congressional representative.

Ask your representative to vote to lift the restrictions on the former Bell companies so that distance learning can become more widely available in the United States.

The education of Courtney Gimble and millions of others is too important to put on hold.

FCC Appropriations

[In millions of dollars]

Year	Chart A (actual dollars)	Chart B (in 1982 dollars)
1980	$68.9	$76.1
1981	76.4	81.1
1982	[1]79.9	79.9
1983	[1]82.9	80.3
1984	[1]88.3	82.0
1985	[1]95.4	85.2
1986 (sequester)	[1]90.4	79.3
1987	[2]96.9	82.1
1988	99.6	81.0
1989	99.6	77.8
1990 (sequester)	107.6	.....
1991	115.8	.....

[1] Includes payment supplemental.

[2] Includes payment supplemental and FERS supplemental.

Senator INOUYE. Thank you very much, Mr. Binz. Proponents of this bill have contended that there are sufficient safeguards in the measure. And when taken together with market conditions, it would reduce anticompetitive behavior among RBOC's. Do you agree with that contention, Mr. Vishny?

Mr. VISHNY. No, I do not, Senator. There is, of course, an attempt to build safeguards into the bill as it is presently constructed. The safeguards are of various kinds. One is a dependence on the ability of the Federal Communications Commission, and, presumably State regulatory bodies, to enforce safeguards.

We would suggest that history shows this not to be the case. In the main, safeguards which are presently proposed existed predivestiture and were inadequate to prevent the abuses which formed the basis for the antitrust action which was brought and ultimately settled.

The safeguards which are suggested at the moment do not undo the fact of the existing local exchange monopoly which now exists, nor do they change that situation. Thus, the incentive as well as the ability to engage in anticompetitive behavior continues and is not likely to change.

Third, in addition to that, we find it difficult to understand how such things as comparable opportunities will be worked out, how purchases at market prices can be adequately defined.

We think that the only real way of protecting the competitiveness of this market is to maintain, enforce, and keep in effect, the structural changes which were set in motion by the MFJ initially and which we believe should be retained.

Senator INOUYE. Thank you. Mr. Binz, do you agree with that observation?

Mr. BINZ. Yes, I do. I think that the key point is the local monopoly, that the structural predicate which existed, when the divestiture occurred, when the antitrust suit was brought. In that respect, things have not changed. In that respect, we have an opportunity right now to learn from what went before as opposed to repeat it.

And I think a short summary of what we are saying is that, even with a separate subsidiary—and let us recall that Western Electric was a separate subsidiary of the AT&T system—even with a separate subsidiary, the burden on regulators is going to be so great to root out the harm to ratepayers. We frankly do not think it is going to happen.

Senator INOUYE. Mr. Weinstock, if the committee adopted your amendment, which would exempt your business, your industry, would you be supportive of the measure?

Mr. WEINSTOCK. I would be supportive of the measure in terms of my interest, of my industry, yes. I am not supportive of the measure in some other areas, but only in how certain things are rectified. I am concerned, as Senator Hollings is, that the purpose, I assume, of this bill, is to get domestic manufacturing back into this country, to have it domestic.

Our industry is domestic manufacturing; that is why I feel the exemption is, is right for us and right for this bill. I would like to see the bill be stronger in domestic manufacturing, even if it does not pertain to our industry. But I would support the bill, except in our industry I believe we should be exempt.

We meet this bill right now. There is nothing to add to bring the seven RBOC's into manufacturing equipment that we manufacture in this country. If anything, it would allow up to 40 percent of the products that are now manufactured here to be manufactured outside the United States.

Senator INOUYE. Thank you. Mr. Gibson, Mr. Vishny represents an organization made up of industries such as yours. Why this difference?

Mr. GIBSON. That is a very good question, Senator. I have spoken with not only the people whose correspondence has been included in my testimony, but a number of other people. I must admit I am unfamiliar, except with a couple of names that he has thrown. Most of the manufacturers that I speak with are very, very committed to this legislation. They believe that it is very critical.

And I think one point really has to be weighed against many of the concerns that were just raised here regarding checks and balances, and whether the BOC's, if given the liberty, would abuse their position. We have to weigh that against the technology that is necessary in this country. We have seven technology manufacturers, seven of the largest in this country. They have an enormous amount to donate.

To me, as a small business, it is critical that we work with them. It is critical that we draw upon their resources and their expertise to guarantee that this country does go into the next century. That is extremely important, and I think it has to be weighed with their concerns.

Senator INOUYE. Thank you, Mr. Gibson. Ms. Easterling, do you believe that, if this measure becomes the law of the land, it will bring back jobs to America?

Ms. EASTERLING. Yes. I think that it will, and that the requirements of the bill, that the RBOC's must find an American manufacturer for a product, or a component rather, before they go overseas. I think that gives an opportunity to a lot of manufacturing companies to look at what is not available now and to begin to manufacture that.

Senator INOUYE. Then am I correct to assume that if the domestic content provision is taken out, you would be opposed to the bill?

Ms. EASTERLING. That is an accurate statement, yes.

Senator INOUYE. Thank you. Senator Hollings?

The CHAIRMAN. Let me thank the witnesses for sticking with us. I want to thank the recorder, thank you and Senator Exon and the staff for staying with us here this evening.

Thank you.

Senator INOUYE. Thank you very much.

Senator Exon.

Senator EXON. Let me join in that. If I have some questions, I will submit for the record. You have put in a long day, as we have, and this is the longest time I have ever spent in a hearing in 12 years, but we are always setting records around here. Thank you. You were a very good panel, and you have been awfully patient and we thank you for coming.

Senator INOUYE. On behalf of the committee, I thank all of you very much.

[Whereupon, at 7:30 p.m., the hearing was adjourned.]

APPENDIX

LETTER FROM MR. ROBERT E. ALLEN, CHAIRMAN OF THE BOARD, AT&T, TO SENATOR INOUYE

MARCH 13, 1991.

Senator DANIEL K. INOUYE,
722 Hart Senate Office Building,
Washington, DC 20510–1102

DEAR MR. CHAIRMAN: If I may, I would like to elaborate on the response which Jim Kilpatric gave to your question at last week's hearing as to our perception of the impact of S. 173 on AT&T's operations.

Let me assure you that the impact on AT&T and on many other U.S. telecommunications equipment manufacturers would be serious indeed. Collectively, the Bell companies represent some 70 percent of the U.S. market for such equipment and nearly a third of the entire worldwide market. Permitting the RBOCs to manufacture telecommunications equipment while they retain their local monopolies would invite them to set up arrangements with affiliated suppliers, with access to privileged design and development information that non-affiliated competitors would not have, thus partitioning a marketplace where the opportunity to compete openly, worldwide, is essential. If Bell markets were foreclosed to AT&T and to other unaligned U.S. manufacturers, there is no other open alternative market anywhere in the world today.

No matter how often Bell company spokesmen may suggest otherwise, removal of the manufacturing restrictions would likely lead to just such alignments with foreign manufacturers, particularly in high-technology switching and transmission systems, where only established companies manufacturing on a global scale can hope to survive. In his study for the Department of Justice in 1987, Peter Huber said that if such alliances occur "with any established manufacturer except AT&T," the result would be "a national disaster of major proportions." The effects would be no different today.

Lifting the manufacturing restriction opens the door to controversies over unfair cost allocations and cross-subsidies from regulated services, and other practices clearly antithetical to competition. The effects would be damaging to AT&T and to all other U.S. telecommunications equipment manufacturers.

Sincerely,

BOB ALLEN.

SUPPLEMENTAL PREPARED STATEMENT OF JIM G. KILPATRIC

At the February 28, 1991 hearing on S. 173 before the Communications Subcommittee of the Senate Committee on Commerce, Science & Transportation, AT&T offered to supplement the record in response to questions by members of the Subcommittee related to AT&T's labor policies, trade issues and research and development.

KEEPING JOBS IN AMERICA

AT&T is one of the United States' largest manufacturers, employing over 100,000 men and women in manufacturing and manufacturing-related jobs. In 19 major plants throughout the country, our skilled workers produce the communications products that this country needs to move into the next century, including lightguide fiber, semiconductors and advanced transmission and switching systems. This includes almost all the equipment AT&T sells to the Bell companies for use in their networks. At the AT&T Bell Laboratories and other AT&T research facilities in the United States, our scientists and engineers perform some $2.4 billion of research and development annually to support our world-wide operations. We are constantly working to improve the quality of AT&T products and increase the productivity of

our U.S. employees. Since divestiture alone, AT&T has expended over $5 billion in capital to upgrade our domestic plants and research facilities, and these investments are on-going.

With limited exceptions, AT&T's offshore plants manufacture equipment for the international market, not for sale in the United States. These operations, which are often a precondition for doing business overseas, benefit the U.S. economy as well. The technology is generated in the United States by American scientists and engineers, as are the designs for the equipment. Many of the components are manufactured in this country and shipped as exports to the offshore plants. Over 2,000 AT&T manufacturing jobs and 400 development jobs in the United States directly support AT&T's international operations.

In a few instances, AT&T had to make the difficult decision to manufacture products for the U.S. market offshore, in order to remain competitive with foreign firms and to support other jobs in the United States. A few years ago, AT&T moved the production of consumer products offshore in response to lower-priced competition from the Far East. By choosing to remain in the consumer business, AT&T has been able to preserve service and sales jobs in the United States, including jobs at its AT&T Phone Stores, and has been able to generate additional revenues to fund new research and development. Recent decisions to subcontract cable connectorization and cord assembly work to Mexico were made for similar reasons, to improve AT&T's competitiveness.

In answer to Senator Exon (Transcript, p. 154), approximately 6,000 people were employed by AT&T in the U.S. in the past decade to manufacture products that are now manufactured overseas. One facility that lost employment as a result of the decision to produce consumer products overseas is our Shreveport, Louisiana plant. In answer to Senator Breaux (Transcript, p. 137), this plant employed approximately 5,000 people in 1974, and employs about 2,200 today. Although the Shreveport workforce is much smaller, it is far more productive than it was because AT&T made the capital investment necessary to make the plant a world-class operation in the manufacture of sophisticated business systems. The Congress has taken due note, and on July 22, 1988, Senator J. Bennett Johnston formally presented AT&T's Shreveport plant with the U.S. Senate Productivity Award for the year 1987. (Attached for the record is the story from the Shreveporter, AT&T's employee magazine).

Thus far, the telephone sector's job loss reflects "the increasing pressures for efficiency in a more competitive world," as Robert Crandall of the Brookings Institution has described in his recent book "After the Breakup" (p. 164). As such, it has been a positive development for consumers. But if S. 173 were enacted, many critical high technology jobs in the U.S. would be lost and not replaced, without any resulting consumer benefit.

The United States is where AT&T manufactures almost all the equipment we sell to the Bell companies for use in their local networks. The Bell companies also buy network equipment from many other U.S. manufacturers, whose trade associations uniformly oppose S. 173. These U.S. operations are at risk for two reasons:

First and most importantly, the Bell companies would have virtually no incentive to procure their equipment competitively. The Justice Department has conceded that the Bell companies would buy their equipment from their affiliates. Moreover, because they do not face local competition, they would do so even if their products were of lower quality or higher price. (*U.S.* v. *Western Electric*, 900 F.2d 283, 302 (D.D.C.), cert. denied, 111 S. Ct. 283 (1990)). Foreclosed from the two-thirds of the market that the Bell companies represent and faced with lower revenues and profits, non-affiliated U.S. manufacturers (including AT&T) could not sustain their current U.S. operations. Most critically, they could not maintain the R&D that yields new products and designs for equipment for the U.S. market and for export. A 1989 Labor Department staff study, referred to in the Senate hearing by Senator Danforth, concluded that an estimated 18,000–27,000 U.S. jobs could be lost if the manufacturing injunction were lifted.

Second, the Bell companies would likely partner with major foreign equipment manufacturers. These foreign affiliates would obtain their equipment design and intellectual property from overseas, for the same reasons that AT&T uses its American R&D in its foreign operations. (This would be permitted even under S. 173's "domestic content" provisions). A serious "brain drain" from the U.S. could result, as R&D for transmission and digital switching and the spin-off technology moved offshore—to countries whose home markets are largely closed to American firms. NTIA cautioned in its 1987 Trade Report that such joint venturing "could pose the threat of destroying this country's indigenous central office equipment manufacturing capacity." (Executive Summary, p. vi).

MAKING A POSITIVE CONTRIBUTION TO THE TRADE BALANCE

The NTIA used strong words in its Trade Report, but strong words are warranted. At the very time the overall telecommunications equipment trade deficit is moving towards a surplus position, the Congress is considering a bill that could reverse the significant gains American firms including AT&T have begun to make in overseas, markets.

The telecommunications equipment trade deficit has fallen 70 percent in the last two years, from $ 2.6 billion in 1988 to $ 0.8 billion in 1990. Exports increased by an average annual rate of 29 percent in 1989 and 1990, while imports have leveled off, increasing less than 2 percent in 1990.

Due to this surge in exports, there is a strong and growing U.S. trade surplus in network equipment (switching equipment and cable, wire and fiber), which reached $ 0.9 billion in 1990. AT&T itself exported some $ 0.8 billion in network equipment from its U.S. factories in 1990, contributing significantly to America's positive trade position in so-called "high end" telecommunications equipment. AT&T's overall exports for 1990 totaled over $1 billion, which—in answer to Senator Breaux—more than made up for AT&T's imports. (Transcript, p. 139).

The category of equipment where there is a chronically high trade deficit is consumer products, for the reasons addressed earlier. Almost all these products—including telephone sets, facsimile machines and answering machines—are produced offshore by AT&T and its many competitors. In response to Senator Breaux (Transcript, p. 138–139), AT&T's imports of consumer products from its offshore manufacturing facilities totaled about $150 million in 1990. (AT&T imported from its overseas facilities some additional $250 in equipment, mainly in microelectronics. These figures are dwarfed by AT&T's total 1990 equipment sales of $12.2 billion, including $1 billion in equipment exports).

Whatever the size of the consumer product trade deficit, S. 173 will do nothing to remedy it; the Bell companies have testified to the Congress that they would not manufacture consumer products. If they did, they would be faced with the same set of economic factors that required AT&T to go offshore. (E.g., Testimony of BellSouth's Chairman John Clendenin to the Senate Communications Subcommittee on April 25, 1990, Transcript, p. 46).

INVESTING IN U.S. RESEARCH AND DEVELOPMENT

The United States telecommunications equipment industry's investment in research and development enables this industry to remain competitive around the globe. Our country's excellent trade results in sophisticated telecommunications equipment reflect the fact that U.S. products are state-of-the-art and fully competitive in world markets. The trade data alone show that United States telecommunications R&D is healthy, rather than in decline as the Bell companies claim.

Industry data on research and development expenditures confirm this as well. U.S. manufacturers' investment in R&D (as a percent of sales) is commensurate with the investments made by of foreign firms. In 1990, AT&T's manufacturing-related R&D equaled 16.4 percent of equipment sales. IBM spent $6.8 billion on R&D, or 10.9 percent of its sales, in 1989 (10–K), and Data General's R&D equaled 13 percent of sales (10–K). Digital Equipment's rate was 12.5 percent (10–K). All these U.S. manufacturers outperformed or equaled the R&D rates cited in Pacific Telesis' written statement for Siemens (Germany), Fujitsu (Japan) and Ericsson (Sweden), which range from 10.3 percent to 11.3 percent of sales.

The Bell companies' lower level of R&D investment is entirely consistent with the nature of their business. They are service companies, not manufacturers. As such, they should not be compared with manufacturing firms—either domestic or foreign. Instead, the correct, "apple-to-apple" test would be to compare the combined R&D rates of the Bell companies-domestic manufacturers with foreign PTTs-captive manufacturers. On the American side, the combined rate for the Bell companies and AT&T, for example, was 17.7 percent. This compares favorably with the combined rates for the foreign firms: E.g., France Telecom-Alcatel, at 14.4 percent; Japan's NTT-NEC at 10.9 percent, and NTT-Fujitsu at 15.6 percent. (These rates are for 1989. The sources are public, principally company annual reports).

In absolute dollar terms, moreover, the fragmented Bell System now spends twice as much on R&D as it spent in 1982, even though its revenues are only 60 percent above 1982 levels. (While AT&T reported lower R&D expenditures in its 1990 annual report, it did not in fact decrease its investment in research and development. The lower figure—referred to by Senator Burns (Transcript p. 154)—merely reflects the fact that some R&D related expenses have been reclassified under new accounting procedures).

The U.S. manufacturing industry's record of excellence in R&D is unquestioned. Its future hinges on its ability to continue to pay for the R&D necessary to bring the next generation of telecommunications products to fruition. (The cost of R&D for the photonic switch alone is estimated to be $2–$3 billion). Before divestiture, paying for R&D was not a concern for AT&T; the Bell companies bought almost all they needed in-house from AT&T. Now manufacturers must earn their revenues in the open marketplace, and they must make a profit. AT&T and other major U.S. firms simply will not have the business incentive to make heavy R&D expenditures if the Bell company marketplace becomes shut to fair competition. S. 173 could then become the prelude to the "national disaster of major proportions" forecast by the Department of Justice in the 1987 Huber Report.

[Shreveporter, July–August 1988]

SENATE HONORS AT&T PRODUCTIVITY

The 1987 U.S. Senate Productivity Award was formally presented to the Shreveport Works in ceremonies attended by over 3,000 employees on July 22.

The award, a framed medallion, was presented by Senator J. Bennett Johnston, Louisiana's senior U.S. Senator, to Paul Wondrasch, AT&T's vice president, manufacturing—customer premises equipment.

The ceremonies were opened by Shreveport Works General Manager Ken Weatherford. In those opening remarks, Weatherford said:

"You look great, Team Shreveport! You should take great pride and satisfaction from these ceremonies. We call ourselves 'Team Shreveport,' that's exactly what we are—a team! The total team effort that has developed and flourished over the past couple of years has brought us this recognition and must be continuously strengthened to achieve our place as a world class competitor. I want to personally thank each and every one of you for your participation and your support.

"With our Shreveport Advantage Program, we have modernized our factory and our manufacturing techniques. We have installed new machinery with the latest technology. We have rearranged the equipment in our factory to improve the material flow. However, the cornerstone of the future and what we have here that distinguishes us from any other manufacturer in the world are the people who make up Team Shreveport. We all know that dedicated, superior people are the difference between runner-up and first place.

"Your superior efforts have allowed us to manufacture and ship about $80 million more worth of output this year than we did last year with the same group of people to accomplish that.

"You have increased your productivity and, at the same time, improved quality ratings by over 50 percent, both of these accomplished with 75 percent less inventory. these are impressive performance figures by anyone's measure and we should be proud.

"I believe we've set an example for other American industry to use in turning around their factories, and we have just begun.

"We have the team spirit and commitment that will keep us on top.

"Today, we are being recognized by the U.S. Senate for accomplishments that can only come from a total team effort.

"The Louisiana Productivity Board evaluated a number of manufacturers in our State and ultimately recommended AT&T's Shreveport Works to receive the award."

Following the award presentation, Weatherford closed the ceremonies with these comments:

"It's been a lot of hard work, but I think we've had a lot of fun and we've grown through this experience.

"And, of course, we're extremely pleased to receive the U.S. Senate Productivity Award and we will display it proudly for all to see. The Shreveport Works was selected for this award for our Advantage Program. It's working, it will continue to work and it will carry us on into the future.

"We have paused here today to reflect on our accomplishments and to receive this honor which symbolizes these accomplishments. What we have done in the past, however, we recognize is nothing more than a foundation for our continuous improvement toward a world class competitor status.

"Our No. 1 enemy is complacency. We must drive ourselves to continue to do the things we're doing, streamline a participative style that enlists everyone's skill for the future. This is not my factory. This is your factory—our factory—and we've got to work to make it successful together.

"I can commit ourselves to Senator Johnston and to Paul Wondrasch that we will continue to improve our efficiency. We will continue to improve our quality. We will continue to improve our productivity. And, with dedication and determination, we will continue to be what we already are: the very best in the world at what we do.

"Often, competition is a dirty word, but not to us. We like competition * * * because we like winning!

"Again, we thank Senator Johnston and the Louisiana Productivity Board for the honor we received today. Speaking on behalf of Team Shreveport, I can assure you that we will continue to live up to the responsibility we feel we were given and we have accepted along with the U.S. Senate Productivity Award."

In his remarks before presenting the U.S. Senator Productivity Award, U.S. Senator J. Bennett Johnston told employees and guests that "quantity and quality is no productivity. So, when we seek productivity we seek quick production, but quality production."

"Why is it so important?" Johnston asked.

Louisiana's senior U.S. Senator continued by saying:

"As we look at the United States with a $160 billion trade deficit, where this country has become, for the first time in its history, a debtor nation instead of a creditor nation that we were for almost two centuries, we realize how important productivity is. With quantity and quality of goods, we can turn around that $160 billion trade deficit. The trade deficit leads first to inflation * * * which means that the dollars we make buy less, less of foreign goods and less of our own goods.

"More importantly, to the extent that we lack productivity, our job base is eroded. We're going to be an exporting nation—the question is whether we export goods or jobs. To the extent we have productivity, we keep our jobs and build on that base.

"Americans, and particularly Shreveporters, can compete on a favorable basis with any workforce anywhere in the world. Believe me, I know. I've been there, I've seen them. You can compete and you've proved it.

"Now how do we get this productivity?

"It begins with attitude. You've got to have the right attitude and I can tell you this group's got the right attitude.

"If you don't have the right attitude, I don't care how many machines you have, how much training you have; you're not going to produce the product. It's a team spirit. Team Shreveport—that's what it takes.

"It takes some other things. It takes capital * * * to make the investment, and that's where those of us in Government come in. We've got to have a taxation policy, and incentive policy, so that companies lie AT&T can afford to invest in the plant and equipment and the high technology which you need to maintain this high rate of productivity.

"Finally, there's creativity, that special quality of genius that enables somebody to think up new methods (like) just-in-time inventory control. That was a stroke of genius. It works.

"Creativity has a lot to do with productivity. That's where Americans have always been at the head of the list. The Japanese are very, very good in their productivity, not so good at creativity. We excel in creativity.

"AT&T has all of these qualities and has put together a team, an effort and a product of which we can all be proud. The communications between management, between product engineers, between assembly workers, between all of you, has been amazing and creative in the way they have put it together. Quality control—so that not one of those telephones moves down the line that isn't checked. They're all high quality.

"I want to say to each one of you, congratulations. It's not only a congratulation, it is also an exhortation to all of us to analyze what we did right here and do it elsewhere. Let's make things better in Louisiana because we can and this is the formula by which we do it."

"The 1987 U.S. Senate Productivity Award serves as an outward sign," Paul Wondrasch said, "of something we in AT&T have known for a long time: AT&T manufacturing has achieved world class stature, and earning a place at the top of our honor roll is the Shreveport Works."

Wondrasch, AT&T vice president, manufacturing—customer premises equipment, accepted the U.S. Senate Productivity Award on behalf of the company. In his acceptance remarks, Wondrasch said:

"This is a proud day for Shreveport and for all of AT&T. Today we celebrate success. The success of the Shreveport Advantage, which has transformed this factory into a model of productivity and manufacturing quality.

"When the men and women of the Shreveport Works banded together in 1986 to launch a massive modernization and training program called the Shreveport Advantage, they set continuous improvement as their goal.

"With that kind of goal, you never stop running the race. But that's the kind of effort that's required to succeed today in the very competitive telecommunications industry.

"The folks at Shreveport showed that they not only could run in this race, but they would be the ones to set the pace. And set it, they have.

"Shreveport employees have learned new, more sophisticated technology, and have helped AT&T launch a number of successful new products for businesses. They've put new manufacturing concepts to work and have assumed personal responsibility for quality/

"They have shared a common vision of excellence and they have made it a reality. And to their credit, they continue the never-ending quest for improvement. While we stop to celebrate today, Shreveport employees know that the race is not won. Each day demands the best they've got to give. They know that AT&T's reputation, and its success in the marketplace, is anchored by the quality and value of the products they produce.

"The Shreveport Works will continue to be the pacesetter for producing the finest in business terminal equipment and for quality and productivity standards that stand up to any in the industry.

"I'm proud of their accomplishments, as are their AT&T colleagues—some 310,000 men and women form around the world. The Shreveport Works is an example to all of us of what can be achieved through vision, teamwork and a commitment to excellence."

LETTER FROM MR. JAMES F. RILL, ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF JUSTICE, TO SENATOR DANFORTH

MARCH 12, 1991.

Honorable JOHN C. DANFORTH,
U.S. Senate,
Washington, DC 20510

DEAR SENATOR DANFORTH: During the hearing on S. 173 held by the Subcommittee on Communications on February 28, 1991, you inquired whether the Department of Justice had stated in 1987 that allowing the Bell Operating Companies to enter into joint ventures with foreign switch manufacturers would be a "national disaster of major proportions." At the hearing I responded that that was not the position of the Department of Justice today. After further researching this statement, I would like to provide some additional information to you and the other members of the Subcommittee regarding its authorship and context. On the basis of this information, I can assure you and the Subcommittee that the Department did not in 1987 generally view all potential BOC joint ventures with foreign (or domestic) equipment manufacturers as unequivocally harmful. Rather, the Department's position concerning Bell Operating Company participation in manufacturing joint ventures has been consistent; joint ventures should be subject to general antitrust standards, and special restrictions on BOC joint ventures are unnecessary.

The statement you brought to my attention at the hearing was not a statement of the Department of Justice. Rather, it appears to have come from a report prepared for the Department by Dr. Peter W. Huber, a consultant to the Department, in connection with the Department's triennial review of the line-of-business restrictions in the AT&T consent decree.[1] In order to provide the full context of Dr. Huber's statement, I quote below the section of his report, at page 14.25, in which the statement appeared:

ANYBODY BUT AT&T

A legitimate concern is that with the relaxation of the MFJ's restriction on line-of-business restrictions some RBOCs would go out looking for major partners or joint venturers in switch manufacturing. In some respects this might be pro-competitive—the U.S. market is currently dominated by two suppliers only, though competition between them and with the smaller new entrants is nonetheless strong. Given recent history in the antitrust courts, however, the unwritten but nonetheless shared understanding might well be that RBOC alliances were permitted with any established manufacturer except AT&T.

If this were to occur, it would be a national disaster of major proportions. The optical super-switches that will be developed in the next few decades will be vital

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[1] *The Geodesic Network: 1987 Report on Competition in the Telephone Industry* (January 1987).

to the national welfare and security—every bit as important as the fifth generation super computers that receive so much more publicity. AT&T is already the only major manufacturer of CO switches that has no affiliation with local exchange companies. On the strength of its own enormous engineering talent and the openness of the U.S. market, AT&T has maintained the health of its equipment business and research operations at Bell Laboratories. It is questionable, however, whether this health could be maintained in the face of an unwritten, anybody-but-AT&T, government policy, developed through an unplanned convergence of piecemeal regulatory and legal decisions.

As discussed in this chapter, there are reasonable arguments that the CO-switch market has developed sufficiently in the past four years to justify removal of the restriction of RBOC entry. But if this particular restriction is to be lifted, it must be with the full and express understanding that RBOC equipment alliances with AT&T are every bit as acceptable as alliances with NEC, Siemens, Ericsson, or NTI.

In short, Dr. Huber expressed the opinion that precluding the BOCs from participating in joint ventures with AT&T would be a "national disaster". He did not oppose permitting the BOCs to enter into manufacturing joint ventures; to the contrary, he stated that such alliances might be procompetitive.

Dr. Huber's report, which analyzed competitive conditions in various telecommunications markets, was prepared as part of the Department's commitment to undertake a periodic review of the need for retaining the line-of-business restrictions in the AT&T consent decree. The Department relied on Dr. Huber's factual findings as support for its recommendation to the Court that several of the line-of-business restrictions, including the manufacturing restriction that is the subject of S. 173, be removed. The Department did not, however, adopt the opinions or conclusions of Dr. Huber, including the passage quoted above, as its own. As I stated in my testimony before the Subcommittee, whether particular BOC joint ventures with equipment manufacturers—foreign or domestic—will adversely affect competition is a matter that can be and should be addressed under the antitrust laws after a full consideration of competitive conditions in the affected markets. In any event, Dr. Huber's statement does not contradict the Department's position on BOG manufacturing joint ventures; that is, that such joint ventures may be procompetitive and should not be subject to a general proscription, but rather should remain subject to general antitrust constraints.

I hope that this clarification is helpful to you and to the Subcommittee, and would request that it be included in the record of the hearing.

I appreciate very much your interest in the competitive effects of lifting the manufacturing restriction in the AT&T consent decree.

Sincerely,

JAMES F. RILL,
Assistant Attorney General.

LETTER FROM MARTA GREYTOK, COMMISSIONER, PUBLIC UTILITY COMMISSION OF TEXAS, TO SENATOR INOUYE

MARCH 22, 1991.

The Honorable DANIEL K. INOUYE,
Chairman, Subcommittee on Communications, of the Committee on Commerce, Science, and Transportation, Washington, DC 20510

DEAR SENATOR INOUYE: Having reviewed the statement of Commissioner Patricia Worthy (D.C. PSC) on behalf of the NARUC on S. 173, the Telecommunications Equipment, Research and Manufacturing Competition Act of 1991, I am concerned that one may take Commissioner Worthy's statement as being negative toward MFJ legislation being passed by the current Congress.

Commissioner Worthy, in her NARUC role as Chairman of the Committee on Communications, outlined her view of NARUC's concerns about S. 173 by interpreting the intent of the 1989 MFJ resolution passed by NARUC's Executive Committee. As a result of my review, I felt it necessary to ensure that a balanced view of the diversity of opinion within the NARUC on this matter is articulated.

In the conclusion of her remarks, Commissioner Worthy states that, "in the judgment of many observers, lifting the restriction while the Bell companies retain their local exchange monopolies might, instead, jeopardize the intense manufacturing competition that now exists." However, upon inspection, the 1989 MFJ resolution does not address this concern, and one should know therefore, that this is only Commissioner Worthy's opinion and not the NARUC's position.

The 1989 MFJ resolution succinctly urges that:

- the Congress include in any statute lifting the MFJ restrictions on RHC * * * manufacturing of telecommunications equipment the explicit requirement that neither Congress nor any Federal agency should preempt the State's authority to engage in regulatory action that any State deems essential to protect monopoly service customers.
- telecommunications equipment sold by one RHC subsidiary to another of that RHC's subsidiaries must be made available to any other company on the same basis.
- the reporting requirements for the FCC's Automated Report Management Information System (ARMIS) must be expanded as necessary in order for the States and the FCC to adequately reconcile cost data and to effectively monitor jurisdictional revenue shifts.

As I said before there is no mention of any concern about the RBOCs "jeopardizing the intense competition that now exists." The only concerns were those that are mentioned above, and those are safeguard-related to protect against cross-subsidization and federal preemption.

You should also be aware that the NARUC Committee on Communications passed a new resolution on the MFJ just last month. You will find that resolution at the top of page 2 begins to address manufacturing. It is the position of the Committee on Communications that:

- the RHCs, or BOCs, or both be allowed to engage in the research and design of customer premises equipment and network equipment.
- the RHCs, or BOCs, or both should not be allowed to fabricate customer premises equipment and network equipment at this time.

The 1991 resolution also embraces the safeguards detailed in the March 1989 Executive Committee resolution. The resolution also says the review of waiver requests should be accelerated and that involved States and the FCC should support waivers of the MFJ restrictions when they are in the public interest. Additionally the resolution makes strong State rights arguments so that each State regulatory commission can impose more stringent ratepayer protection than the FCC.

I sit on both the Executive Committee and the Committee on Communications for the NARUC, and from my seat on these committees I have not observed a distinctive negative policy toward S. 173 or of lifting the restrictions in general. In fact I believe that most commissioners would characterize the 1989 resolution as neutral and certainly the 1991 resolution as being positive toward the lifting of the MFJ restrictions on manufacturing. In your review of the NARUC testimony, I hope this distinction remains clear.

And finally, I respectfully request that this letter and the accompanying 1991 NARUC Committee on Communications resolution be made part of the record in the matter of S. 173.

Respectfully submitted,

MARTA GREYTOK,
Commissioner.

RESOLUTION ON MFJ RELIEF

Whereas, the Modified Final Judgment (MFJ) administered by U.S. District Court Judge Harold Greene prohibits the Bell Regional Holding Companies (RHCs) and Bell Operating Companies (BOCs) from providing information services, manufacturing telecommunications equipment, and providing interLATA services; and

Whereas, Congress is considering legislation to modify the MFJ restrictions; and

Whereas, the U.S. District Court for the District of Columbia will reconsider whether the information services restriction should be retained, modified or removed; and

Whereas, the Executive Committee of the National Association of Regulatory Utility Commissioners adopted a position on March 1, 1989 with regard to the kinds of actions States should be allowed to take in order to protect monopoly service customers if any MFJ restrictions are lifted; and

Whereas, the Communications Committee has thoroughly considered the issues of lifting the MFJ restrictions, including exhaustive debate, special conferences, member surveys and expert presentations over a period of several years; now, therefore, be it

Resolved, That the Executive Committee of the National Association of Regulatory Utility Commissioners (NARUC), assembled at its 1991 Winter Meetings in Washington, DC, supports lifting the MFJ restrictions on the RHCs' and BOCs' provision of information services in its entirety, subject to the safeguards enumerated in the March 1, 1989, NARUC MFJ resolution, the additional safeguards enumerated in

this resolution, and provisions that afford competitors nondiscriminatory unbundled access to the network; and be it further

Resolved, That any action lifting the information services restrictions should not include the provision of interLATA transmission of information services by RHCs, or BOCs, other than providing signalling across LATA boundaries to reach a single data base serving multiple LATAs with such signalling carried by an authorized interLATA carrier, and be it further

Resolved, That any action lifting the information services restriction must assure that all local exchange carriers participate in the development of the infrastructure thereby ensuring access to new information age technology and services by all telephone subscribers, including those in rural areas; and be it further

Resolved, That the RHCs, or BOCs, or both be allowed to engage in the research and design of customer premises equipment and network equipment; and be it further

Resolved, That the RCHs, or BOCs, or both should not be allowed to fabricate customer premises equipment and network equipment at this time; and be it further

Resolved, That the MFJ restriction on the provision of interLATA services should not be lifted at this time; and be it further

Resolved, That the RCHs, or BOCs, or both should be afforded the opportunity for accelerated review of their requests for waivers of the MFJ restrictions; and be it further

Resolved, That where the public interest is served by a waiver, the NARUC urges the involved state(s) and the FCC to support a waiver for the provision of products or services otherwise subject to the line of business restrictions; and be it further

Resolved, That in any legislation enacted by Congress which lifts the current MFJ restrictions and allows the FCC to regulate the relationship among RHC subsidiaries, or BOC subsidiaries, or subsidiaries of both, FCC rules should apply to interstate services only, and State rulemaking should regulate intrastate services; and be it further

Resolved, That NARUC reaffirms its support for the safeguards enumerated in the March 1, 1989, MFJ resolution; and be it further

Resolved, That any legislation enacted by Congress which allows RHC, or BOC, or both entry into any currently restricted area should provide States the authority to audit the books of unregulated operations of the RHC, or the BOC, or both; and be it further

Resolved, That any legislation enacted by Congress which allows RHC, or BOC, or both entry into any currently restricted area should allow States to impose more stringent ratepayer protection than the FCC.

Sponsored by the Communications Committee.

LETTER FROM MR. GEORGE H. BARBOUR, COMMISSIONER, STATE OF NEW JERSEY BOARD OF PUBLIC UTILITIES, TO SENATOR INOUYE

APRIL 10, 1991.

Honorable DANIEL K. INOUYE,
U.S. Senate,
Washington, DC 20510

DEAR SENATOR INOUYE: Commissioner Patricia M. Worthy, Chairman of the Washington, DC Public Service Commission, submitted a statement of behalf of the National Association of Regulatory Utility Commissioners (NARUC) to the Senate Communications Subcommittee of the Committee on Commerce, Science, and Transportation concerning S. 173, the Telecommunications Equipment, Research and Manufacturing Act of 1991. After my review of that statement, I wish to add my voice to that of Marta Greytok, Commissioner of the Texas Public Utility Commission, in calling your attention to the NARUC's official position. I agree with Commissioner Greytok, who has already sent a letter to you and your colleagues in the Senate, that the position of NARUC differs from Commissioner Worthy's characterization. Because of the complexity and importance of the legislation, I respectfully request that this letter be made part of the record in the matter of S. 173 to ensure that all positions are properly represented during its consideration.

As a member of both the NARUC Executive and Communications Committees, as a Past President of NARUC, 1985–86, and as a member of various communications Joint Boards between the Federal Communications Commission and NARUC over the past 15 years, I have witnessed the extensive review and debate that the NARUC has devoted to Modified Final Judgment (MFJ) relief. While the 1989 official NARUC position is relatively neutral regarding manufacturing relief, I fully support Commissioner Greytok's contention that neither Commissioner Worthy's

statement nor the official NARUC positions accurately reflects the diversity of opinion among the NARUC members concerning MFJ relief.

The position of the Communications Committee, based on the more recent 1991 resolution, is that the Bell Operating Companies (BOCs) be allowed to engage in the research and design of customer premises and network equipment. Several Commissioners like myself urge that the ban on manufacturing also be lifted, which will result in more competition, innovation, and benefits to the consumer. The BOCs understand the need of local telephone customers and would be able to respond more effectively to those needs through development and manufacture of equipment.

Commissioner Greytok notes that appropriate regulatory safeguards at the state and federal levels are included in both the 1989 and 1991 NARUC resolutions. It is my view that these safeguards will provide adequate protection to the ratepayers and that the BOCs will not jeopardize the competition that now exists, but in fact, by their entry, strengthen the competition in an effective and meaningful manner so that citizens across our country will all benefit by the BOCs presence and the increase effective competition thereby resulting.

I hope that this letter has helped to further clarify the various positions concerning S. 173 within the NARUC. I appreciate your consideration.

Sincerely,

GEORGE H. BARBOUR,
Commissioner.

LETTER FROM MR. MIKE LAMB, PRESIDENT, ADVANCED ELECTRONIC APPLICATIONS, INC., TO SENATOR HOLLINGS

FEBRUARY 14, 1991.

The Honorable ERNEST F. HOLLINGS,
U.S. Senate,
Washington, DC 20510–4002

DEAR SENATOR HOLLINGS: Thank you for your support of the Telecommunications Equipment Research and Manufacturing Competition Act of 1991, S. 173, legislation. I believe that the proposed legislation will create a more amicable environment for the development of telecommunications products and services.

As president of Advanced Electronic Applications, Inc., a small engineering and manufacturing company involved in the communications industry, I have felt the burden of business lost due to the current law that prohibits the Bell companies from reasonable manufacturing and engineering activities. I believe that the current law prohibits the most efficient process of engineering and manufacturing in the telecommunications industry. The proposed legislation would liberate companies such as AEA, to participate in business partnerships with the Bell companies in the design and development of telecommunications equipment.

Ultimately, this proposed legislation will greatly reduce the cost of providing telecommunications services to the public. As the current barriers to manufacturing and engineering activities are removed, there will be more and more small companies competing for the business that will result from the collaboration of the Bell Telephone Companies with small businesses. I believe that the opportunity provided in passage of this new legislation would motivate local economic growth and would encourage healthy market competition in the telecommunications industry.

Thank you for your attention to the concerns of the small business. I think we would all welcome a more efficient environment for the development of telecommunications products and services.

Best regards,

MIKE LAMB,
President.

LETTER FROM MR. JOSEPH M. GREENLEAF, PRESIDENT, EVERETT SOUND MACHINE WORKS, INC., TO SENATOR HOLLINGS

FEBRUARY 15, 1991.

The Honorable ERNEST F. HOLLINGS,
U.S. Senate,
Washington, DC 20510–4002

DEAR SENATOR HOLLINGS: Thank you for your support of Senate Bill 173. We at ESMW have been manufacturing telecommunication exchange iron work for over 36 years and support bill S. 173 as written.

We feel that we cannot work as cost effectively or make as many new products available without removal of the artificial carriers to telephone company participation in the manufacturing process. Close collaboration has always resulted in the best most effective solution.

We feel we wouldn't be manufacturing telecommunications equipment today if we couldn't have been able to work closely with the telecommunication engineering force in the past as we have.

Thank you for your time in reviewing my comments and we at ESMW applaud your efforts toward the enactment of bill S. 173.

Respectfully,

JOSEPH M. GREENLEAF,
President.

LETTER FROM MR. BRUNO STRAUSS, VICE CHAIRMAN, ELDEC CORP., TO SENATOR HOLLINGS

FEBRUARY 14, 1991.

The Honorable ERNEST F. HOLLINGS,
U.S. Senate,
Washington, DC 20510–4002

DEAR SENATOR HOLLINGS: Thank you for your support of the Telecommunications Equipment Research and Manufacturing Competition Act of 1991: S. 173. This bill goes a long way—probably not far or fast enough—to remove artificial barriers to innovation and productivity.

Competitiveness cannot and should not be legislated. Our best customer, Boeing, has virtually all of the capabilities—including fabrication—of its vendor-base and could easily be our most serious competitor. The reason they are not, and are instead our biggest customer, is enlightened self-interest. They want our participation because there are many things which we can do better and faster. There is a "natural order of things" which the free marketplace determines and regulates quite well.

The potential vendors to the telecommunication industry do not require or desire protection.

Sincerely,

BRUNO STRAUSS,
Vice Chairman.

LETTER FROM MR. RICHARD J. LAPORTE, PRESIDENT—CEO, APPLIED VOICE TECHNOLOGY, INC., TO SENATOR HOLLINGS

FEBRUARY 14, 1991.

The Honorable ERNEST F. HOLLINGS,
U.S. Senate,
Washington, DC 20510–4002

DEAR SENATOR HOLLINGS: I write this letter as the president of Applied Voice Technology, Inc., a Kirkland, WA-based telecommunications equipment company, to let you know that I strongly support Senate Bill 173, Telecommunications Equipment Research and Manufacturing Competition Act of 1991 and encourage your efforts to revise the AT&T consent decree so that the Regional Bell Operating Companies can participate in the equipment manufacturing process.

As a manufacturer and marketer of voice and call processing equipment, we are dependent on the sales and support efforts of interconnect phone dealers and regional telephone companies, including the Bell Operating Companies, to market and support our products. Unfortunately, the consent decree not only prohibits the Bell Operating Companies from manufacturing customer premise equipment, it severely limits their ability to resell equipment manufactured by companies such as ours. Consequently, we find our company placed at a competitive disadvantage to those larger competitors, many of whom are foreign corporations who use direct sales forces to market their products in the United States.

In addition, we believe the Regional Bell Operating Companies to be an excellent source for outside capital financing and strategic partnering. The consent decree prohibits them from this activity as well.

I have read the provisions of S. 173 and I do not believe the Bell Operating Companies would present a threat to an independent manufacturer like AVT. To the contrary, the proposed legislation would remove barriers and open up opportunities

for creative synergism, collaborative efforts, and economic growth, surrounding development of telecommunication products and services.

I urge you to support the bill and share our feelings with your colleagues in the Senate. I thank you for taking the time to understand my position.

Yours truly,

RICHARD J. LAPORTE,
President—CEO.

LETTER FROM MR. JOHN C. MARTIN, CHAIRMAN, FLOWMOLE CORP., TO SENATOR HOLLINGS

FEBRUARY 19, 1991.

The Honorable ERNEST F. HOLLINGS,
U.S. Senate,
Washington, DC 20510–4002

DEAR SENATOR HOLLINGS: I am writing in support of S. 173, the Telecommunications Equipment Research and Manufacturing Competition Act of 1991. This bill would remove the manufacturing restriction imposed on the former Bell companies by the AT&T divestiture. As a manufacturer in Washington State, I have a vested interest in this legislation.

In my view, S. 173 goes a long way toward fixing a situation where the remedy has been worse than the illness. In theory, the manufacturing restriction was to protect small manufacturers like ourselves from unfair competition by the former Bell companies. In fact, the restriction has made if difficult to work with the Bell companies in a collaborative way.

I am hopeful that in removing the restriction, S. 173 will make it possible to capitalize on the financial strength and the network and customer "know-how" of Bell companies. Those assets, combined with our manufacturing capability, will enable us to grow our businesses and add new jobs to the Washington economy.

I may find it desirable to joint venture with the Bell companies. While the legislation permits this, it unnecessarily limits such relationship to "a" (single) regional Bell company. I would like the ability to partner with any or all of the regions, or any combination thereof.

Additionally, I have some concern that S. 173, as written, would require that any company involved in joint venture with a Bell company by subject to the same regulation as Bell. Such a requirement would drastically limit the appetite to participate in joint ventures with Bell companies.

In addition, the Bell companies could be a source of inexpensive capital. Their impressive financial strength, however, would be diluted by the provision of the legislation dealing with debt financing. From my perspective, maintaining a centralized credit approach would better enable the Bell companies to finance manufacturing ventures.

Also of concern is the provision on minority ownership. Apparently the rationale is that minority owners will act as "private enforcers" to keep the Bell's manufacturing affiliate in line. This role is better left to the Securities and Exchange Commission or some other regulatory agency.

I am hopeful that as S. 173 moves through the process, these details can be worked out. The more obstacles there are to be working with our customers, the less opportunity there is to make investment and create jobs.

S. 173 is a good start. Lifting the MFJ manufacturing restriction will have a positive impact on the economy. I urge your support, and respectfully as that these comments be made part of the hearing record of S. 173.

Sincerely,

JOHN C. MARTIN,
Chairman.

LETTER FROM MR. ROBERT L. TOPEL, PRESIDENT, CREST INDUSTRIES, INC., TO SENATOR HOLLINGS

FEBRUARY 20, 1991.

The Honorable ERNEST F. HOLLINGS,
U.S. Senate,
Washington, DC 20510–4002

DEAR SENATOR HOLLINGS: We urge you to support S. 173 that would allow Regional Bell Companies to manufacture.

Crest Industries is a small developmental and manufacturing company that has designed and manufactured quality products for the telephone industry since 1969.

Prior to the 1982 Consent Decree by Federal Judge Harold Greene, Crest enjoyed a working relationship with the Bell Companies designing and manufacturing products and special assemblies to meet their customer needs and specifications.

Since the additional court order of 1987 prohibiting the Bell Companies from engaging in detailed conversation of discussions with vendors or manufacturers about development, design or customer specifications, Crest has suffered significant loss of revenues and jobs.

We need legislation to promote the Bell Companies to use small U.S. manufacturers for their special manufacturing needs. Regulations must permit and promote (not restrict) a highly communicative process between the U.S. manufacturers and the Bell Companies to identify customer needs.

Thank you for taking the time to read our comments, and again, we urge you to support S. 173.

Sincerely,

ROBERT L. TOPEL.
President.

LETTER FROM MR. R.W. BRUNKOW, EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER, ICOM AMERICA, TO SENATOR HOLLINGS

FEBRUARY 22, 1991.

The Honorable ERNEST F. HOLLINGS,
U.S. Senate,
Washington, DC 20510–4002

DEAR SENATOR HOLLINGS: This letter is to indicate ICOM America's support of the Telecommunications Equipment Research and Manufacturing Competition Act of 1991, S. 173, legislation. ICOM America is a relatively small engineering and manufacturing firm in the communications industry.

We believe the current law which prohibits the Bell companies from manufacturing and engineering activities creates an artificial barrier that prevents the most efficient process of engineering and manufacturing in the telecommunications industry. The proposed legislation would significantly remove those barriers and create a more efficient environment for development of telecommunications products and services. This would greatly reduce costs of providing telecommunications service to the public.

The proposed legislation would allow small manufacturers, such as ourselves, to participate as business partners with the Bell companies in the design and development of telecommunications products. If successful, S. 173 would enable us to capitalize on the financial strength and the network and customer "know-how" of Bell companies like US WEST. Those assets, combined with our manufacturing capability, would enable us to grow our businesses and add new jobs to the Washington economy. As more small companies compete for the business that would result from subcontracting work from the Bell companies, better products would be developed at less cost to the public because of that open market competition.

We urge your support of S. 173 as we feel it would have a positive impact on our firms and on the economy. Thank you for taking the time to review these comments and for supporting S. 173.

Best regards,

R.W. BRUNKOW,
Executive Vice President and General Manager.

LETTER FROM MR. ROD L. PROCTOR, CEO, TONE COMMANDER SYSTEMS AND TELTONE CORP., TO SENATOR HOLLINGS

FEBRUARY 15, 1991.

The Honorable ERNEST F. HOLLINGS,
U.S. Senate,
Washington, DC 20510–4002

DEAR SENATOR HOLLINGS: I'm writing to thank you for your support of S. 173 which would permit the Bell telephone companies to conduct research on, design and manufacture telecommunications equipment.

My father started a telephone equipment manufacturing business in 1957. That company, Proctor & Associates, spun off several other companies in the Seattle area

(Teltone, Tone Commander and Melco) who all manufactured electronic equipment for the telephone industry. These companies had a combined employment of 1,500 during their peak in the early 1980's. The combined employment of these companies is currently less than 250. The breakup of the Bell system caused these companies to lose a large portion of their traditional Bell operating company business. These manufacturers tried to react to the change in the market, but failed for the most part in the post-divestiture environment. The owner of Melco was forced to sell his company after years of supplying equipment to the Bell system. All of these companies would have grown and prospered if they had been allowed to have a normal relationship with their traditional customers.

I've been the CEO of Tone Commander Systems and Teltone Corp. My mission at both of these companies was to turn around their downward spiral after the Bell System breakup. A major frustration was my inability to work closely with our potential largest customer, the Bell companies. S. 173 would solve this structural problem.

The Bell companies need to design and conduct research on telecommunications equipment to meet their own needs. They should also be allowed to manufacture equipment. They would most likely contract out most manufacturing work to other companies since there is excess capacity in all sectors of our industry. This would be an advantage to many of our local companies who currently are doing contract manufacturing for companies outside the telecommunications industry. They would much rather manufacture equipment that is ideally suited for their manufacturing processes. They would add a great deal of value to the manufacturing process.

I feel that if we were allowed to work with the Bell companies without the MFJ restrictions that the consumer would be better served, and the United States could start the process to regain its worldwide telecommunications leadership. It's important from a competitiveness point of view that this country have the best telecommunications system in the world. This would also create manufacturing companies with the technology and manufacturing capability to compete for a significant export opportunity.

I can only see benefits for small companies if S. 173 is passed. The backbone of the U.S. industry is the small and medium sized companies. The larger companies, except for AT&T, are foreign controlled. (Northern Telecom, Siemens, NEC, Alcatel, L.M. Erickson, etc.) This bill would bring back the incentive to "Buy America." The dismantling of the Bell System damaged the telecommunications manufacturing infrastructure in the United States. The Bell companies need to be able to define, research, design and manufacture the equipment that will make them competitive. The companies that I've run would like to design and manufacture exactly what the Bell companies want. We could cut development time and reduce costs if we had a normal working relationship with our customers. What we can't do is define products without customer input and we need the support of customer provided research, or the funding of some of our research. The best products come from a close working relationship between the customer and the manufacturer.

Thanks again for your continued support of this critical issue.

Sincerely,

ROD L. PROCTOR.

LETTER FROM MR. DON SYTSMA, PRESIDENT, METEOR COMMUNICATIONS CORP., TO SENATOR HOLLINGS

FEBRUARY 15, 1991.

The Honorable ERNEST F. HOLLINGS,
U.S. Senate,
Washington, DC 20510–4002

DEAR SENATOR HOLLINGS: This letter is to acknowledge MCC's support of the Telecommunications Equipment Research and Manufacturing Competition Act of 1991, S. 173, legislation. MCC was founded in 1975 as an engineering and manufacturing firm in the meteor burst communications industry. We service a niche market for both DOD and commercial applications that could be very complementary to the Bell companies.

We are currently addressing the mobile data communications market for the transportation industry, both in the United States and Europe. To be successful requires strategic partnering to translate our innovations into successful products on a global scale. We are currently having discussions with the European PTTs. US West and other Bell companies could also be ideal strategic partners to assist the development, engineering, and production of these new innovative telecommunica-

tions products and services. However, current law prevents this. The proposed legislation would remove these barriers and permit our industry to begin working effectively with Bell companies to our benefit and the benefit of the public.

Being innovative is not enough for this country to compete in the global markets. We must translate our innovations into successful products in the marketplace sooner and more effectively than our global competitors. The effect of these regulations has been to impede our ability to meet that partnering with Bell companies in all phases of the manufacturing process that can lead to economic growth for our industry and competitiveness in the open market.

Thank you for taking the time to review these comments.

Sincerely,

DON SYTSMA,
President.

LETTER FROM MR. LEON B. SKIDMORE, PRESIDENT/GENERAL MANAGER, BSM SYSTEMS, INC., TO SENATOR HOLLINGS

FEBRUARY 15, 1991.

The Honorable ERNEST F. HOLLINGS,
U.S. Senate,
Washington, DC 20510–4002

DEAR SENATOR HOLLINGS: Thank you for your support of S. 173, Telecommunications Equipment Research and Manufacturing Competition Act of 1991.

BSM Systems Inc. is a small company manufacturing telecommunications equipment used in the industrial and broadcasting industry. The need to be able to work with and provide services to any company which needs the technology a company such as BSM has cannot be stressed enough. I believe that S. 173 will provide the access that our company needs into the advanced technology of the telecommunications market. By allowing the Bell Companies to export their R&D, provide funding, specifications, and other related data to a company such as ours would be a valuable service. We feel that we are very competitive in this market and the Bell Companies would be a source of business to us. As long as the playing field and the rules are the same for all of us, competition will only bring new innovation, competitive pricing and better customer service. Therefore I as that you continue supporting S. 173 and allcw the Bell Companies to "manufacture."

Very truly yours,

LEON B. SKIDMORE,
President/General Manager.

LETTER FROM MR. BRIAN DEUTSCH, PRESIDENT, FOURSUM INTERNATIONAL INC., TO SENATOR HOLLINGS

FEBRUARY 21, 1991.

The Honorable ERNEST F. HOLLINGS,
U.S. Senate,
Washington, DC 20510–4002

DEAR SENATOR HOLLINGS: Thank you for your support for S. 173, Telecommunications Equipment Research and Manufacturing Competition Act of 1991.

Foursum International, Inc. is a small business concern devoted entirely to servicing the Bell Operating Companies. We manufacture a broad spectrum of products for use in the Public Pay Telephone sector and we have gained much experience as a provider of product to the Bell System.

Our company has had several major frustrations in our dealings with the Bell System. Most of these frustrations are a direct result of policy changes forced on the Bell System by the Modified Final Judgment decree. The restrictions on research, development and manufacturing affiliation have cost us a great deal of potential business by mitigating the free flow of ideas to and from the Bell Companies. The Bell System is rapidly losing its technical base and has become a monolith managed by risk adverse attorneys and other nontechnical staff.

We believe that the Telecommunications Equipment Research and Manufacturing Competition Act of 1991 that is presently before the Senate will promote a return to technical leadership for the Bell System and for the United States in general. By no means are we advocating a return to the days of predivestiture when competition was nonexistent. Rather, we support a fair and open market that allows the formation of strategic partnerships and enhances our global competitiveness.

Thank you very much for your consideration in this matter. It is our hope that you have a clear understanding of the positive impact this legislation would have on the American technology industry.

Sincerely,

BRIAN DEUTSCH,
President.

LETTER FROM MR. GENE KIMMELMAN, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA, TO SENATOR HOLLINGS

FEBRUARY 22, 1991.

DEAR SENATOR: On behalf of the Consumer Federation of America (CFA), I urge you to oppose S. 173, Senator Hollings' Telecommunications Equipment Research and Manufacturing Competition Act of 1991. Chairman Hollings' S. 173, in its current form, fails to protect telephone ratepayers against significant rate increases that would likely occur if the Bell telephone companies are allowed to manufacture telecommunications equipment for their own local telephone networks.

Unless new regulatory tools are developed that prevent cross-subsidization like no past or current regulation is able to do, consumers stand to lose more than they could gain from lifting the AT&T consent decree's manufacturing restriction. The hypothetical promises associated with Bell company manufacturing are far overshadowed by the likelihood that regulation can neither protect competition nor prevent the Bell companies form loading excessive costs onto monopoly, basic voice services.

Because the Bell companies continue to possess bottleneck control over monopolistic local service markets, they would have a financial incentive to purchase overpriced network equipment from an affiliated manufacturing operation. Since ratepayers have no alternative provider of local phone service, they would be required to pay excessive local rates to finance the monopoly profits of an unregulated Bell manufacturing operation.

If the Bell companies were allowed to manufacture and purchase equipment from themselves, they could drive many small manufacturers out of business and generally impeded competition in the equipment market. By developing equipment with insider knowledge of their own network growth projection, configuring their networks to make equipment uniquely suited for their specific infrastructure design, and by spreading research and development (or other untraceable) costs into the regulated rate base, the Bell companies could easily circumvent the most diligent regulatory policing and foreclose major equipment markets from competition.

CFA believes the committee should correct these problems with S. 173 before completing action on the legislation. Carefully crafted amendments could ameliorate many consumer concerns about Bell company entry into the manufacturing market.

However, in its current form, CFA opposes S. 173 and requests that the committee take more time to devise stronger safeguards against cross-subsidization that would insulate consumers from local rate increases and prevent reduced competition.

Sincerely,

GENE KIMMELMAN,
Legislative Director.

LETTER FROM MR. RICHARD D. MCCORMICK, PRESIDENT, US WEST, TO SENATOR HOLLINGS

FEBRUARY 26, 1991.

The Honorable ERNEST F. HOLLINGS,
U.S. Senate,
Washington, DC 20510

DEAR SENATOR HOLLINGS: I wish to commend you and the subcommittee for holding the February 28 hearing on S. 173, the Telecommunications Equipment Research and Manufacturing Competition Act of 1991. I hope that the committee will favorably report this important legislation to the full Senate at its earliest possible convenience.

Sam Ginn, Chairman and Chief Executive Officer of Pacific Telesis, is testifying on behalf of all seven regional holding companies. I support and endorse the testimony he will give to this committee.

I believe that this legislation is in the best interest of the U.S. economy by promoting competitiveness in domestic and global telecommunications markets, stimulating employment opportunities in the United States, and ensuring U.S. leadership in developing innovative technologies. We will continue to work for its enactment.

Sincerely,

DICK.

LETTER FROM MR. EDWARD E. WHITACRE, CHAIRMAN AND CEO, SOUTHWESTERN BELL CORP., TO SENATOR HOLLINGS

FEBRUARY 26, 1991.

The Honorable ERNEST F. HOLLINGS,
U.S. Senate,
Washington, DC 20510

DEAR MR. CHAIRMAN: I wish to commend you and the subcommittee for holding the February 28 hearing on S. 173, the Telecommunications Equipment Research and Manufacturing Competition Act of 1991. I hope that the committee will favorably report this important legislation to the full Senate at its earliest possible convenience.

Mr. Sam Ginn, Chairman and Chief Executive Officer of Pacific Telesis, is testifying on behalf of all seven Bell Holding companies. I support and endorse the testimony he will give to this committee.

I believe that this legislation is in the best interest of the U.S. economy by promoting competitiveness in domestic and global telecommunications markets, stimulating employment opportunities in the United States, and ensuring U.S. leadership in developing innovative technologies. We will continue to work for its enactment.

Sincerely,

ED WHITACRE.

LETTER FROM MR. J.L. CLENDENIN, CHAIRMAN OF THE BOARD, BELLSOUTH CORP., TO SENATOR HOLLINGS

FEBRUARY 26, 1991.

The Honorable ERNEST F. HOLLINGS,
U.S. Senate,
Washington, DC 20510

DEAR MR. CHAIRMAN: My apologies for being unable to testify before the Commerce Committee on the February 28 hearings on S. 173. I greatly appreciate your continuing leadership on this issue and was looking forward to the opportunity to present my views on behalf of the industry. I hope the committee will once again favorably report his legislation to the full Senate.

It is important that our industry be allowed to fully participate in the manufacturing process. Research, design, development and fabrication are necessary if the industry is to have the incentive to achieve the job growth, increased hi-tech R&D and improved American presence in hi-tech global markets. I believe that S. 173 is in the best interests of the U.S. economy and we will continue to work for its enactment.

Mr. Sam Ginn, Chairman and Chief Executive Officer of Pacific Telesis, is testifying on behalf of all seven Bell Holding companies. I support and endorse the testimony he will give to this committee.

Sincerely,

J.L. CLENDENIN.

LETTER FROM MR. RAYMOND W. SMITH, CHAIRMAN OF THE BOARD AND CEO, BELL ATLANTIC CORP., TO SENATOR HOLLINGS

FEBRUARY 26, 1991.

The Honorable FRITZ HOLLINGS,
U.S. Senate,
Washington, DC 20510

DEAR MR. CHAIRMAN: I wish to commend you and the subcommittee for holding the February 28 hearing on S. 173, the Telecommunications Equipment Research and Manufacturing Competition Act of 1991. I hope that the committee will favor-

ably report this important legislation to the full Senate at its earliest possible convenience.

Mr. Sam Ginn, Chairman and Chief Executive Officer of PacTel, will be expressing Bell Atlantic's views in supporting this legislation.

I believe that this legislation is in the best interest of the U.S. economy. It will promote U.S. competitiveness in domestic and global telecommunications markets and will stimulate employment opportunities in the United States. It will also ensure U.S. leadership in developing innovative technologies.

We will continue to work for the bill's enactment.

Sincerely,

RAYMOND W. SMITH.

LETTER FROM MR. WILLIAM L. WEISS, CHAIRMAN AND CEO, AMERITECH CORP., TO SENATOR HOLLINGS

FEBRUARY 26, 1991.

The Honorable ERNEST F. HOLLINGS,
U.S. Senate,
Washington, DC 20510

DEAR MR. CHAIRMAN: The upcoming hearing on your legislation, the Telecommunications Equipment Research and Manufacturing Competition Act of 1991 (S. 173), is vitally important to consumers, international competitiveness, and the future of the Nation's infrastructure.

The Chairman and Chief Executive Officer of Pacific Telesis Group, Sam Ginn, will be a witness at the February 28 hearing and is appearing on behalf of the seven regional holding companies, including Ameritech. As an articulate and insightful leader in this industry, I am certain that the views expressed by Mr. Ginn will benefit your committee's deliberations.

Please be assured that Ameritech stands with you on this landmark legislation and will be continuing to do all that we can to secure its passage by the 102d Congress.

Sincerely,

BILL.

LETTER FROM MR. WILLIAM C. FERGUSON, CHAIRMAN AND CEO, NYNEX, TO SENATOR HOLLINGS

FEBRUARY 26, 1991.

The Honorable FRITZ HOLLINGS,
U.S. Senate,
Washington, DC 20510

DEAR MR. CHAIRMAN: I wish to commend you and the subcommittee for holding the February 28 hearing on S. 173, the Telecommunications Equipment Research and Manufacturing Competition Act of 1991. I hope that the committee will favorably report this important legislation to the full Senate at its earliest possible convenience.

Mr. Sam Ginn, Chairman and Chief Executive Officer of Pacific Telesis, is testifying on behalf of all seven regional holding companies. I support and endorse the testimony he will give to this committee.

I believe that this legislation is in the best interests of the U.S. economy and will continue to work for its enactment.

Sincerely,

W.C. FERGUSON.

LETTER FROM MS. GAIL GARFIELD SCHWARTZ, DEPUTY CHAIRMAN, STATE OF NEW YORK PUBLIC SERVICE COMMISSION, TO SENATOR INOUYE

APRIL 10, 1991.

The Honorable DANIEL K. INOUYE,
U.S. Senate,
Washington, DC 20510

DEAR SENATOR INOUYE: Recently Commissioner Patricia Worthy submitted a statement on behalf of the National Association of Regulatory Utility Commissioners (NARUC) on this matter. This statement underscores that NARUC takes no stand

on whether the restrictions should be lifted, but asks Congress, in the event it does modify the restrictions, to ensure that safeguards are in place and that states have the authority to enforce them.

Of course, I concur with the standing NARUC resolution, but in my opinion it does not go far enough. The Communications Committee of the NARUC passed a resolution on the subject Feb. 27, 1991, by a substantial majority, which supports in part the objectives of S. 173. I was an initial sponsor of this resolution, which also passed the Communications Committee by a majority of more than 2 to 1 in July, 1990, and I continue to support it.

The Communications Committee resolution says, inter alia, that the Committee resolves That the RHCs, or BOCs, or both be allowed to engage in the research and design of customer premises equipment and network equipment.

It is my opinion as an economist that restrictions on manufacturing might safely be lifted with the proviso that no BOC be allowed to purchase from its own RHC affiliate.

This restriction seems particularly important to New York, because we have had several bad experiences with improper transactions between the regulated New York Telephone Company and its unregulated affiliates, and we are investigating presently to determine the extent of resulting harm to ratepayers.

I respectfully request that this letter be made part of the record in the matter of S. 173.

Sincerely,

GAIL GARFIELD SCHWARTZ,
Deputy Chairman.

STATEMENT OF GAIL GARFIELD SCHWARTZ

I would like to thank the members of the subcommittee for this opportunity to comment on the staff draft legislation, and particularly thank Chairman Markey for his invitation to do so, extended to state regulatory commissioners at the 1990 NARUC winter meeting.

As an economist who has written several books on industrial policy and economic development, and numerous articles on those subjects and on telecommunications, and who has advised federal, state and local government on such matters, I support the objective of this draft legislation.

As a state regulator, whose responsibilities clearly will be affected by the proposed draft legislation, I believe it important to say that the draft legislation represents a major step forward in the debate concerning the MFJ line of business restrictions imposed upon the Bell regional holding companies (RHCs). Congress should reassert its prerogative in the formulation of national telecommunications policy, and this legislation intends to do so in a progressive and enlightened manner.

The laudable objective of the draft is to eliminate counter-productive handicaps to U.S. firms. The draft recognizes that giving regulators responsibility and sufficient flexibility to respond to changing conditions following RHC entry into currently restricted business is essential if the real benefits to be gained are not to be canceled by discriminatory, anti-competitive behavior. We cannot know beforehand what the appropriate balance is between safeguards against such behavior and the economic inefficiencies associated with these safeguards. Flexibility must be given all regulators to respond quickly to actual RHC behavior and changing market conditions.

In this regard, I have several suggestions to make.

First, I would like to address the very difficult issue of whether separate subsidiaries should be required as a condition of entry into currently prohibited lines of business. The difficulties surrounding this determination are perhaps best illustrated by the history of the Federal Communications Commission'S (FCC) various computer inquiries, where it has flip-flopped on the issue of structural versus accounting separation. The draft legislation itself would require separate subsidiaries for certain new lines of business, but provides for the possibility of FCC waiver of this requirement after three years following enactment of the legislation.

The dilemma this issue presents for policy makers stems from the trade-off between safeguards against anti-competitive behavior and cross subsidy after entry by Bell Company affiliates, and the economic efficiency of integrated operations. The closer a particular business is to basic network operations, the greater is the loss of integration economies caused by structural separation. Yet, the closer another business is to basic network operations, the greater is the potential for abusive behavior. Thus the need arises for a seperate subsidiary.

There is no easy resolution of this dilemma. The draft legislation wisely emphasizes safeguards by initially requiring separate subsidiaries for information services and manufacturing functions, while allowing for the possibility of subsequent waivers of this requirement. This will allow further examination of the issue after there is some substantial experience with the operation of separate subsidiaries in these businesses. On balance this approach offers a reasonable opportunity for all RHCs to enter chosen markets on equal terms, and for regulators to oversee the results.

I do have some reservations, however, about the nature of the FCC proceeding required prior to any partial or total waiver of the separate subsidiary requirements. In my opinion the importance of the generic subsidiary issue warrants the same thorough evaluation as the draft requires before allowing entry into specific lines of business.

Prior to letting RHCs into in-region information content and certain other businesses, the draft legislation requires the FCC to conduct a proceeding and report its findings to Congress. By contrast, the draft legislation would give the FCC sole discretion to waive the separate subsidiary requirement provided it finds that such waiver (a) will not impair the ability of the commission or state commissions to verify compliance with this part and (b) will not permit anti-competitive practice between a telephone operating company and any of its affiliates.

My concern is that no outside input in making for reviewing the findings is required. For example, in the proceedings required for permitting additional fabrication authority, an explicit role is specified for the secretary of Commerce.

This omission is particularly troubling given that the FCC is already on record in its Computer Inquiry III regarding information services: it intends not to require subsidiaries. This makes it all the more essential that the legislation ensure an impartial and thorough assessment. I suggest that any bill require the FCC to conduct a generic proceeding (NPRM) prior to lifting any separate subsidiary requirements. The FCC determinations following the proceeding should be reported to Congress.

My second point also concerns subsidiaries. The draft legislation would leave the decision as to ownership of the new subsidiaries to the RHCs themselves, except in the case of equipment fabrication, which could only take place through a subsidiary of the RHC. I believe this would be a mistake. There are very good reasons for requiring these subsidiaries to be owned by the operating companies.

First, these are businesses that are all relatively close to the core telecommunications business of each regional company. They are not entirely different enterprises like real estate and financial services, which by virtue of their lack of relation to the core business should be undertaken (if at all) in entities owned by the holding company. More importantly, operating company ownership of manufacturing and information services subsidiaries would assist both state and federal regulators in monitoring and policing, any possible cross-subsidies and/or anti-competitive behavior. This structure affords regulators greatest access to books and records, and the greatest oversight over financial transactions. Moreover, a structure of operating company ownership (including joint ownership by operating companies of a region where desired) would not produce any competitive disadvantage for the RHCs in these markets.

Let me illustrate my point with some recent experience we have had in New York. NYNEX Material Enterprises Company (MECO), which provided functions very closely related to the daily operations of New York Telephone (NYT), has been a wholly owned subsidiary of the holding company. We began to suspect overcharging to NYT and other abuses by MECO as early as 1986, and although we took immediate steps to stop these practices and prevent ratepayers from being harmed, we were unnecessarily hampered in the efforts by the fact that MECO was owned by NYNEX. This put MECO largely outside our regulatory reach.

NYNEX Service Company, in contrast, is jointly owned by NYT and New England Telephone Company, and we have had no problems with this arrangement. The MECO case illustrates that problems of detecting and controlling cross-subsidies are greatly magnified by RHC ownership of subsidiaries. This structure serves no legitimate purpose where the subsidiaries perform functions that are closely related to, and leveraged off of, network operations.

Another concern is the prospect of waivers related to equipment fabrication on a case-by-case basis. Unless Congress clearly establishes a general class of activities for which waivers would be virtually automatic, this ad hoc approach could unduly retard entry into this line of business. There has been a huge waiver log jam in Judge Greene's Court, and it is important that it not be replicated. Uncertainty is the enemy of sound business decisions, and the waiver process would continue the uncertainty the RHCs face. The economic benefits of entry into fabrication would be realized fully only if the firms face clear investment choices, and as many as possible, at one time. "Inching up" On these choices would be contrary to good strategic

planning. A superior alternative would be to permit equipment fabrication, defined as Congress deems appropriate, but prohibit own-self sale of telecommunications (network) equipment. Thus, each RHC would be foreclosed from equipment sales to its own operating companies, but would have access to the markets of the six other regions, as well as the broader world market. This approach would have the following advantages:

(a) It would effectively eliminate concerns of discriminatory procurement, cross-subsidization and non-arm's-length purchase of overpriced and/or inferior equipment.

(b) It would provide a true market test of manufacturing capability. If any region's manufacturing arm produces high quality, competitively priced equipment, BOCs in the other regions will buy it. If not, they won't.

(c) It would not require the potentially unwieldy, expensive, and contentious proceedings that may result from the proposed draft's approach.

Admittedly, all else equal, foreclosure of an RHC from any part of the world market is undesirable. However, this might be an acceptable trade-off for the certainty and other advantages provided by this approach.

Regardless of the approach used to safeguard against anti-competitive or discriminatory behavior, the proposed requirement that permitted fabrication be conducted exclusively within the united states should be eliminated. This provision will result in the type of distortion the draft legislation in general attempts to eliminate. Practically speaking, it would most likely be counter productive. The intent is to guarantee jobs for U.S. workers, but the result would be to inhibit production either domestically or overseas. It would be economically impossible for the RHCs to compete with other companies not subject to this constraint.

I turn next to the joint board mandated by the draft legislation. While laudable in intent, this provision, in my judgment, will not accomplish its purpose as currently written. I believe it should be redrafted, taking account of the deficiencies of existing joint board practices and procedures.

Most, if not all, state regulators believe existing joint boards are ineffective and inefficient. Joint boards were established to deal with one national monopoly's different regulatory environments—federal and state. They are not suited to the complexities of an increasingly competitive telecommunications environment, or to the volatile regulatory situation states and the FCC face. This revision to parts of the Communications Act of 1934 provides the much-needed opportunity to rectify the joint board deficiencies, and to experiment with different formats for resolving jurisdictional conflicts between states and the FCC.

Specifically, the legislation should give states more authority in actual decision making. It attempts to do in Section 257(d), by requiring the FCC to take joint board direction. FCC refusal to take a joint board recommendation should be reported to Congress.

Moreover, the boards should have an uneven number of members, and states should choose their own representatives. There should be adequate funding for staff work, and for regularly scheduled meetings. The FCC should not have sole power to determine schedules and agendas, as is now the case.

An effective joint board approach requires clear direction from Congress as to the areas subject to its review, the ability of states to propose matters for its attention, and where a matter is clearly an intrastate issue under present legislation, a clear statement that it be referred to a federal state conference, with no implication that states abrogate their jurisdictional rights through participation. An illustration arises under Section 251, part (8) which grants the FCC jurisdiction to approve, subject to criteria in the legislation, any alteration or modification of existing exchange areas (LATAs). This authority should not reside exclusively with the FCC, but instead should be joint authority with any affected states.

As a final comment, I note that while the draft legislation stipulates many requirements for the various FCC proceedings to be held, there is no general requirement that these proceedings be full and open evidentiary hearings (as opposed to "paper" proceedings). Such a requirement would be desirable. At the least, provision should be made for states or other parties to request full evidentiary hearings.

Again, thank you for the opportunity to comment on this draft legislation.

LETTER FROM MR. PHILLIP D. MINK AND MS. MICHELE A. ISELE, CITIZENS FOR A SOUND ECONOMY, TO SENATOR HOLLINGS

FEBRUARY 27, 1991.

The Honorable ERNEST F. HOLLINGS,
U.S. Senate,
Washington, DC 20510

DEAR SENATOR HOLLINGS: On February 28, Commerce, Science, & Transportation Committee Members will consider S. 173, the Telecommunications Equipment Research and Manufacturing Competition Act of 1991. CSE believes that this bill is an important first step toward creating a telecommunications industry that will most enhance U.S. competitiveness and economic growth. Because of the importance of this issue, CSE urges you to disregard objections to the bill raised by AT&T and other manufacturing firms.

The U.S. telecommunications industry annually saves the nation billions of dollars in labor and capital costs by making other industries more efficient. Today, telecommunications is the leading provider of infrastructure services to business, well ahead of electrical power, transportation, and other infrastructure providers.

Telecommunications has taken on this preeminent role because of the convergence of computer and communications technologies. Computers can convert virtually any kind of information—video, data, voice, and the like—into an electronic digital language, which can be transmitted through a telephone network that is increasingly computer-based.

Even as computer and communications technologies are changing the world economy, the manufacturing ban prevents the seven Bell companies from fully developing those technologies. Nevertheless, opponents to S. 173, including AT&T and several trade associations, assert that that ban is necessary to prevent monopoly abuse. AT&T argues that Congress should lift the ban only when local telephone service is competitive.

Congress need not wait. The Bell companies' local telephone franchises are subject to extensive state and federal rules designed to prevent abuse. By all indications, those rules work: The Bell companies compete in a wide array of nonregulated businesses—cellular telephone service, marketing telephone equipment, printing yellow pages, and a host of nontelecommunications businesses—without raising telephone bills or discriminating against telephone company competitors. The same rules that govern Bell competition in those businesses would govern Bell manufacturing competition. Indeed, S. 173 codifies several of those rules.

Continued development of the U.S. telecommunications network is essential to continued economic growth and international competitiveness. The manufacturing ban impedes that development. We therefore urge you to lift the ban.

Sincerely,

PHILLIP D. MINK.
MICHELE A. ISELE.

LETTER FROM MR. HENRY GELLER, COMMUNICATIONS FELLOW, THE MARKLE FOUNDATION, TO SENATOR HOLLINGS

FEBRUARY 28, 1991.

Chairman ERNEST HOLLINGS,
U.S. Senate,
Washington, DC 20510

DEAR MR. CHAIRMAN: I write to strongly support the legislation introduced by you to remove, subject to appropriate safeguards, the restrictions on manufacturing network or customer premises equipment in the Modified Final Judgment (MFJ) in *U.S.* v. *AT&T,* 552 F. Supp. 131 (D.D.C. 1982).

It is simply wrong to suppress the competition of over one-half of the U.S. telecommunications industry in this important sector. Further, without manufacturing facilities, the divested Regional Companies (RBOCs) cannot reasonably be expected to engage fully and effectively in the R&D that is vital to this dynamic area.

It may be that some of the RBOCs, who will be starting from ground zero, will choose not to enter these competitive markets. But at a time when U.S. trade negotiators are pressing to open foreign markets to U.S. manufacturers to improve the U.S. balance of trade, it makes no sense for the U.S. government to deny entry into those markets to seven large companies with extensive telecommunications experience.

Further, even if some do not enter on an all-out basis, removal of the restrictions will be helpful in several ways. Thus, it will allow them to participate significantly by directly assisting or joining with small manufacturers and others in the design and development of new equipment. It will end the serious definitional disputes that have arisen as to what constitutes "manufacturing"—disputes that have prevented the RBOCs from participating effectively in the design of telecommunications equipment that could markedly benefit the network.

As to the claim that RBOC entry will bring with it anti- competitive practices, your bill contains strong safeguards against this. In this connection, it is important to bear in mind that the RBOCs do not replicate the prior AT&T/Western Electric situation; each represents but one region, and if they engage in manufacturing, must do so on a national—indeed, global—basis. There is simply no need to protect AT&T and the foreign manufacturers from the competition of the RBOCs.

I hope that the foregoing is helpful to you in your consideration of this important legislation.

Sincerely yours,

HENRY GELLER.

NATIONAL ASSOCIATION OF COUNTIES—RESOLUTION REGARDING THE REMOVAL OF THE MANUFACTURING RESTRICTIONS ON LOCAL TELEPHONE COMPANIES

Whereas, America's international competitiveness and continued economic growth have become extremely dependent upon maximizing domestic research and design, development, manufacture, and marketing from all U.S. companies; and

Whereas, between 1983 and 1988, combined research and development investment by AT&T and the Bell Operating Companies grew at an average annual rate of 9.9 percent, while in Japan and Europe telecommunications research and development investment grew annually at 26 and 34 percent, respectively; and

Whereas, it is unacceptable that any foreign company, even those affiliated with state-owned telephone monopolies, can manufacture and sell telecommunications equipment in the United States, but that seven of our leading local telephone companies are prohibited by judicial restrictions from doing so; and

Whereas, the continued imposition of the restrictions of the Modified Final Judgment (MFJ) on the Bell Operating Companies (BOCs) denies to America the benefits of having several of its most knowledgeable and capable domestic telecommunications companies being able to perform domestic research and design, develop, and manufacture software and telecommunications equipment for residential, business and governmental telecommunications users; and

Whereas, removal of the manufacturing restrictions on these local telephone companies would help stimulate domestic investment in research, development, design and manufacture of new and innovative telecommunications technologies and facilitate access of said innovations to all local telephone companies; and

Whereas, domestic telecommunications markets and services, as well as, international telecommunications developments have drastically changed since the original imposition of the 1982 MFJ restrictions upon the BOCs; and

Whereas, adequate accounting and structural safeguards have been developed and are already in place in federal and state jurisdictions to protect against cross subsidization from telephone customers; and

Whereas, it is the responsibility of Congress, rather than the courts, to determine national telecommunications public policy including its effect on economic competitiveness, national security, and foreign trade which are essential elements of a sound national policy:

Therefore, be it resolved, That the National Association of Counties calls upon the U.S. Congress to vigorously support legislation which would, with appropriate consumer and industry safeguards, allow all local telephone companies to perform research and design, development, and manufacture of software and telecommunications equipment; and

Be it further resolved, That any actions by Congress regarding the removal of the manufacturing restrictions on local telephone companies, must reflect proper considerations of the local and state responsibilities for local and intrastate telecommunications services; and

Be it further resolved, That the staff of the National Association of Counties transmit copies of this resolution to the President and Vice President of the United States, the Speaker of the House of Representatives, the President of the Senate and to every member of the Congress of the United States.

NATIONAL CONFERENCE OF BLACK MAYORS, INC.—RESOLUTION REGARDING THE REMOVAL OF RESTRICTIONS ON LOCAL TELEPHONE COMPANIES

Whereas, education, employment and access to information are key to the economic prosperity of African Americans and all other Americans; and

Whereas, permitting the regional Bell companies to participate in the manufacture and design of telecommunications equipment will spur the growth of jobs in telecommunications and promote the availability of beneficial telecommunications to everyone; and

Whereas, between 1983 and 1988, combined research and development investment by AT&T and the Bell Operating Companies grew at an average annual rate of 9.9 percent, while in Japan and Europe telecommunications research and development investment grew annually at 26 and 34 percent, respectively; and

Whereas, removal of the manufacturing restrictions on these local telephone companies would help stimulate domestic investment in research, development, design and manufacture of new and innovative telecommunications technologies and facilitate access of said innovations to the local telephone companies;

Now, therefore be it resolved, That the National Conference of Black Mayors, Inc. (NCBM) calls upon the U.S. Congress to vigorously support legislation which would, with appropriate consumer and industry safeguards, allow all local telephone companies to perform research and design, development, and manufacture of software and telecommunications equipment.

Be it further resolved, That the National Conference of Black Mayors will transmit copies of this resolution to the appropriate congressional committees.

PREPARED STATEMENT OF MR. PAUL H. VISHNY

My name is Paul H. Vishny. I am General Counsel of the Telecommunications Industry Association (TIA). I appreciate the Opportunity to appear before the Subcommittee to convey to you TIA's views concerning S. 173 and the important public policy issues raised by this legislation, which would in effect eliminate the MFJ restriction on Bell Operating Company entry into the telecom manufacturing business.

As you know, the association's Chairman, Mike Birck, was scheduled to testify on behalf of TIA. Unfortunately, due to the recent change in the hearing schedule, he is unable to appear before the Subcommittee today. I regret Mike's absence because he has a wealth of "hands-on" experience in the industry to share with the Subcommittee. With this in mind, I would commend to you Mike's written testimony, which describes in greater detail the beneficial impact which the more open, competitive environment created by the MFJ has had on Mike's own company, Tellabs, Inc., and on the domestic telecom equipment industry as a whole.

At the outset, let me emphasize that TIA supports S. 173's stated goal of enhancing this nation's industrial competitiveness. However, TIA continues to believe that removal or substantial modification of the MFJ manufacturing restriction at this time would have a significant adverse impact on competition, innovation, consumer welfare, and the competitiveness of the U.S. equipment industry in domestic and foreign telecommunications markets.

TIA vigorously disputes the central premise of S. 173, i.e., the notion that the telecom equipment industry in the U.S. is "on the brink of disaster" and that removal of the MFJ restriction is needed to "rescue" the industry and make it globally competitive. As the statistics cited in Mike's written statement and in the attached study of the U.S. telecom equipment industry indicate, the more competitive, dynamic industry structure which has emerged under the MFJ has greatly strengthened the domestic telecom manufacturing sector, which today includes literally thousands of firms, many of them world leaders in the development of advanced telecommunications products. Under the MFJ, R&D expenditures by the domestic telecom industry have increased substantially, prices for equipment of all types have fallen, there has been a proliferation of new and improved products, and equipment is available from a wider range of suppliers than ever before. In the highly competitive post-divestiture marketplace, domestic equipment manufacturers have become increasingly efficient and, therefore, better prepared to compete effectively both within and outside the U.S.

The increasing strength of domestic manufacturers in "leading-edge," high-tech telecom equipment markets is reflected in the Commerce Department's most recent trade figures. In 1990, the U.S. balance of trade for types of telecommunications equipment improved by more than $1.1 billion, and our trade surplus in high-technology telecom products increased in an equally dramatic fashion, from $1.1 billion in 1989 to $2.3 billion in 1990.

Given the enormous strides made by U.S. manufacturers in penetrating previously closed foreign markets in the years since divestiture, it would be a grave mistake for Congress to conclude that removal of the MFJ manufacturing restriction constitutes a viable means of enhancing the global competitiveness of the domestic telecom equipment industry. Indeed, the most predictable effect of removal of the MFJ manufacturing prohibition is the formation of RBOC alliances with foreign manufacturers in the strategically significant central office switch market and, potentially, in other product areas as well. As the analysis appended to TIA's written testimony indicates, S. 173's proposed "domestic-content" provision would not prevent the BOCs from entering into arrangements with foreign suppliers which threaten to reduce domestic employment, allow foreign manufacturers to increase their market share and their profits at the expense of U.S. firms, and hand foreign suppliers a leading role in the evolution of technology critical to the future of the telecommunications infrastructure in the U.S.

More broadly, permitting the Bell Operating Companies to enter the telecom manufacturing business would inevitably lead to a return of the same types of practices which served to limit competition, innovation, efficiency and growth within the domestic telecom equipment industry prior to divestiture. Elimination or substantial modification of the manufacturing restriction would also undermine the increasingly cooperative relationship between the BOCs and the supplier community that has merge under the MFJ. Regulatory "safeguards" simply cannot be as effective in ensuring a fully-competitive, efficient, dynamic equipment industry in the U.S. as the structural approach embodied in the MFJ.

Without question, action can and should be taken by the Congress to further advance the international competitiveness of U.S. manufacturers. TIA's written testimony includes a summary of the association's recommendations for achieving this objective. In addition, Congress may wish to consider legislation which, rather than increasing the opportunities for misconduct, seeks instead to encourage the emergence of meaningful, market-based constraints on the BOCs' ability to abuse their monopoly power, through the introduction of competition into the local telephone business. If properly implemented, such an approach might ultimately provide a viable basis for permitting BOC entry into the telecom manufacturing business, by attacking the source of the problem which gave rise to the MFJ restrictions in the first instance.

Again, thank you for the opportunity to appear before the Subcommittee. I would be pleased to answer any questions you might have.

PREPARED STATEMENT OF CONGRESSWOMAN CARDISS COLLINS

Mr. Chairman, thank you for giving me the opportunity to testify before the Communications Subcommittee today on S. 173 and competition in the telecommunications industry. It is always a pleasure and an honor to appear before this body.

For many years now, I have worked to see that minority- and women-owned small businesses are given an opportunity to participate in our national economy. As a member of the House Telecommunications and Finance Subcommittee and as Chair of the Government Operations Subcommittee on Government Activities and Transportation, I used the combined jurisdictions of these panels to work diligently to help ensure equal access to contracts and capital for small disadvantaged businesses (SDB). One of my largest undertakings was working with U.S. Sprint and AT&T to ensure a substantial representation of small businesses in FTS-2000, the multi-billion dollar project to upgrade the Federal government's telephone system. My interest in 5DB access to business opportunities with the Regional Bell Operating Companies (RBOC) is an outgrowth of my involvement in telecommunications and minority business issues.

Let me say at the outset that I have not made a final decision on support for S. 173, or any measure to lift the restrictions on the Bell Operating Companies. However, I want to make clear my interests regarding the legislation and its potential impact on minority and other small disadvantaged businesses. My concerns regarding the lifting of restrictions run along two lines: first, I am interested in preserving the supplier and subcontracting relationships that have developed between the Bell Operating Companies and SDBs should the restrictions be lifted; and, second, I am vitally interested in forging additional relationships, such as increased availability of venture capital and increased research and development funding, for new and existing SDBs.

The break-up of the Bell system, coupled with the deregulation of telephone equipment, created unique opportunities for entrepreneurship. Prior to the divestiture, SDBs found it difficult to contract with the Bell system. Since then, I am

pleased to say, the. number of opportunities has increased significantly. The seven Regional Bell Operating Companies are among the largest companies in our country, annually buying more goods and services than virtually any other seven aggregate businesses in the U.S. To supply the Bell Operating Companies with telecommunications equipment and services, scores of minority suppliers have gone into business and prospered since the Modification of Final Judgment (MFJ) was put in place. These suppliers, including Native Americans, Asian-Americans, Hispanic Americans, African Americans and women, provide equipment, fire and burglar alarm systems, telephone system installation, and scientific and technical services, to name a few. Dedicated to providing high-quality products and services at competitive prices, they are top-notch and can compete with anyone when they are allowed to do so on equal footing. As you consider S. 173, I hope you will carefully review the record of performance and any risks to small and minority businesses, such as unfair product pricing and limited access to contracting information, if the Bell Operating Companies are allowed to manufacture.

Along these same lines, should instances of self-dealing and other anti-competitive practices be attempted by the BOCs, they could preclude SDBs from competing fairly with subsidiaries of the Bell Operating Companies. Therefore, I concur with you that strong safeguards are essential and should include separate entity requirements for all Bell manufacturing activities, as specified in S. 173, as well as, the mandate that SDBs and other contractors will be able to sell customer premise and other telecommunications equipment to the BOCs at the same terms and conditions applicable to Bell subsidiaries.

My second major concern is in providing added incentives for the Bell Operating Companies to invest in small business ventures which may arise to meet new business needs created should MFJ restrictions be lifted. The Regional Bell companies represent over half of the telecommunications assets in this country. If the manufacturing restriction is lifted, it should be commensurate with provisions calling for investment in research, design and development of products manufactured by SDBs, the establishment of venture capital funds, and the creation of joint ventures between the Bell Companies and minority entrepreneurs.

I commend Senator Hollings for provisions in S. 173 requiring that the Bell Operating Companies conduct all manufacturing activities in the U.S., using only American-made components, unless a good faith effort to locate such a supplier fails. I urge you, Senator Hollings, to incorporate provisions along a similar vein regarding small and minority-owned businesses. In addition, I think two key provisions in S. 173 are essential to developing and maintaining the competition that this Congress and the marketplace will demand: first, the section in the bill calling for equal access to contracting opportunities for manufacturers other than the BOCs own manufacturing affiliate, and second, the section mandating that BOC purchases from their manufacturing affiliate must be done at the "open market price." I cannot stress enough how important an open, competitive bidding process will be to SDBs and other businesses.

Senator Hollings, if I can be of any assistance to you in addressing these issues, I will be happy to do so. Again, Mr. Chairman, I thank you for the opportunity to appear here today.

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